Economic and Fiscal Review
Province of Ontario

Ontario

Ministry of
Treasury and
Economics

November 1986

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Preface

The October 1985 discussion paper entitled "Reforming the Budget Process" outlined a number of proposals to enhance the Budget process by ensuring greater involvement of the public and Members of the Legislature. This Economic and Fiscal Review is part of the Government's efforts to improve the pre-budget discussions and consultative process, leading to the development of Ontario's annual Budget. In Spring, 1986, the Legislature set up the Standing Committee on Finance and Economic Affairs to "consider and report to the House its observations, opinions and recommendations on the fiscal and economic policies of the Province."

This Review has been prepared to assist the Committee, other members of the Legislature and the general public in deliberations and discussions on the forthcoming 1987 Ontario Budget.

The Ontario Economy: Performance and Prospects

Ontario Economic Outlook at a Glance

	1985	1986	1987
Real Growth (%)	4.7	4.1	3.6
Inflation (%)	4.0	4.0	3.5
Job Creation (000s)	159	156	114
Unemployment Rate (%)	8.0	7.0	6.7

In 1987, Ontario's labour force will grow to over five million people and the gross provincial product will exceed $200 billion.

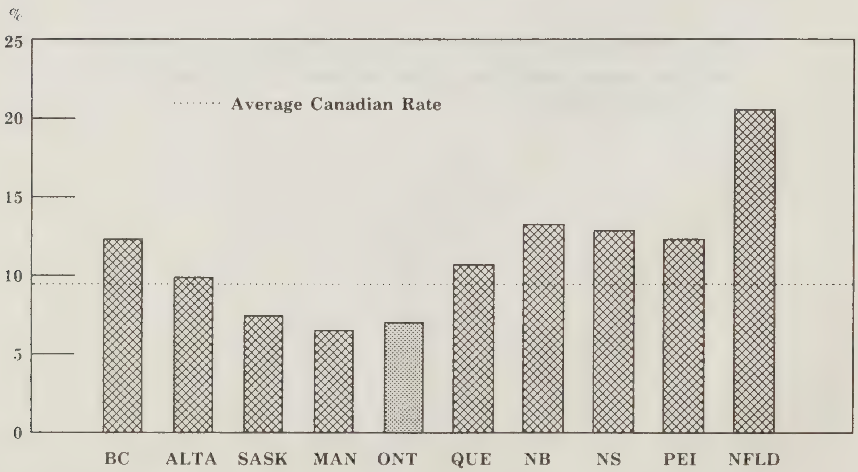
Recent Performance

The Ontario economy is now in its fourth consecutive year of growth following the 1981-1982 recession. That recession was brought on by a dramatic increase in real interest rates and the severe downturn in the U.S. economy. Consumer demand, especially for durable goods such as automobiles, dropped sharply, while businesses curtailed investment activity. The result was the deepest recession since the Great Depression of the 1930s.

Vigorous U.S. growth in 1983 and 1984 provided the initial engine for an export-led recovery. Ontario exports grew by about 38 per cent from 1982 to 1984, in large part due to higher automotive trade with the United States. In 1985, although U.S. economic growth slowed, Ontario's economy registered a third year of robust growth. The Ontario expansion became more broadly based, with domestic consumption and investment providing a greater contribution to overall economic growth.

Ontario's economy suffered more severely than other jurisdictions in the 1981-82 recession. Real output in Ontario declined, from the pre-recession peak to the trough, by 7.2 per cent compared to 6.6 per cent for Canada as a whole and 3.4 per cent for the United States. Equally significant is the fact that the recovery was particularly strong in Ontario. Throughout the expansion, Ontario's economy has experienced stronger growth than the rest of Canada. From 1982 to 1985, Ontario's real output grew by 18.7 per cent, compared to 13.1 per cent for Canada as a whole. Over the same period, Ontario's employment rose by 8.2 per cent, compared to 5.0 per cent in other parts of the country.

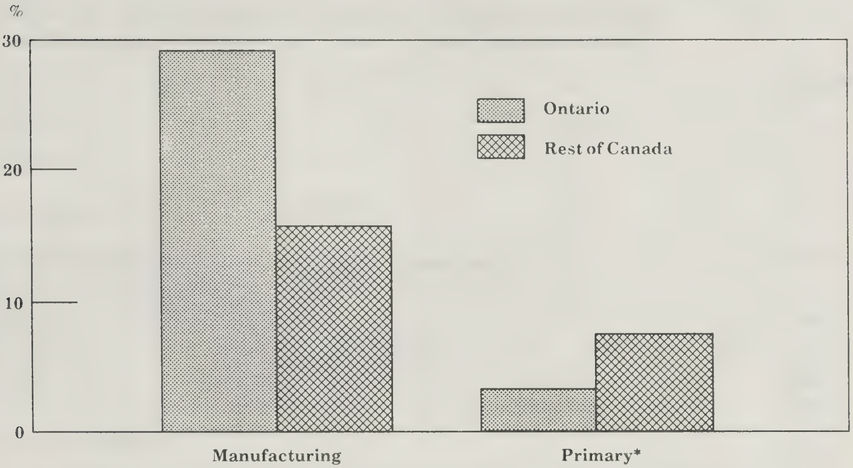
UNEMPLOYMENT RATES BY PROVINCE, SEPTEMBER 1986
(Seasonally-Adjusted)



Source: Statistics Canada.

Ontario's economy is more heavily oriented towards manufacturing and less to primary resource industries than is the rest of Canada. In large part, this orientation accounts for the relatively strong performance of the Ontario economy.

SHARES OF REAL OUTPUT, 1985
MANUFACTURING AND PRIMARY SECTORS

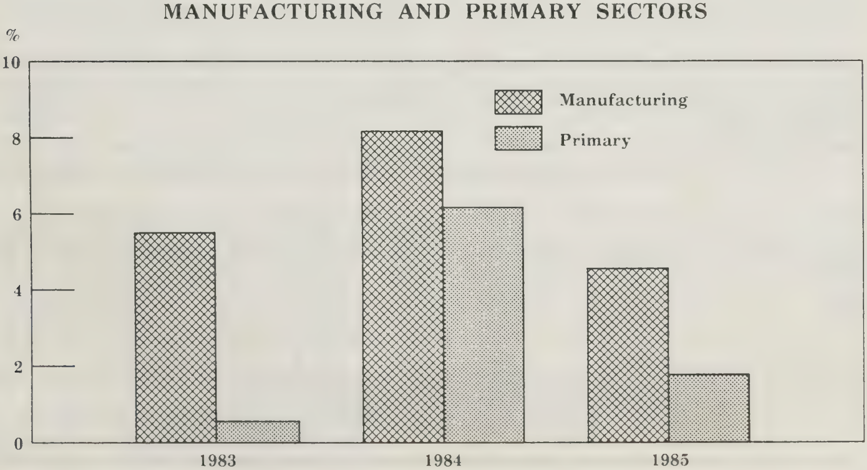


* Agriculture and Fishing, Forestry, Mining, Quarrying and Oil Wells

Source: Statistics Canada and Conference Board of Canada.

During the recovery, growth in manufacturing output, particularly automobile production, has outperformed that of primary industries.

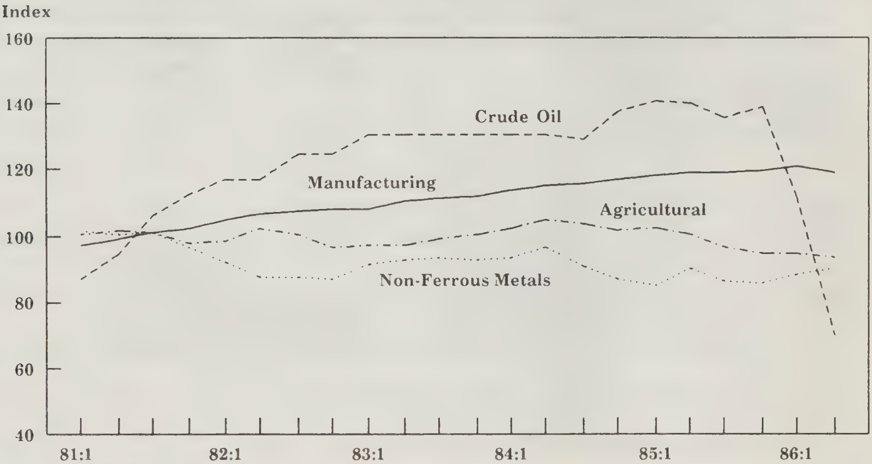
REAL OUTPUT GROWTH IN CANADIAN
MANUFACTURING AND PRIMARY SECTORS



Source: Statistics Canada.

The relative strength in manufacturing is also reflected in the performance of prices in that sector relative to those in the resource sector. Manufacturing prices increased by almost 20 per cent between 1981 and 1986. However, agricultural and metals prices drifted down. Crude oil prices, after rising steadily over the last five years, plummeted in the first half of this year.

MANUFACTURING, AGRICULTURAL, CRUDE OIL AND NON-FERROUS METALS PRICE INDICES
(1981 = 100)



Source: Statistics Canada.

Parts of Ontario or its economy have experienced adverse effects from the generally low commodity prices. For example, Northern Ontario is an important exception to the overall strength in the province's economic performance. Table 1 shows the unemployment rates by region since 1980.

Ontario Unemployment Rates by Region, 1980 to 1986 **Table 1**
(Per Cent)

	East	Central	South West	North East	North West	Ontario
1980	8.0	5.9	9.6	8.0	7.2	6.8
1982	9.2	9.1	11.4	14.8	10.3	9.8
1985	8.6	7.5	8.4	10.6	10.2	8.0
1986 (January-September)	8.0	6.5	7.3	11.1	11.3	7.2

Source: Statistics Canada and Ontario Ministry of Treasury and Economics.
Note: Due to changes in regional boundaries and survey methodology, pre-1984 data are not strictly comparable with later data.

Key Factors and Assumptions: 1986-1987

Ontario's economic performance is closely tied to external developments. The four most important are:

- economic growth, particularly in the United States, but also in Western Europe and Japan;
- economic growth in the rest of Canada and the fiscal actions of the federal government;
- federal monetary policy, changes in interest rates and foreign exchange rates; and
- the price of oil and natural gas.

The U.S. and World Economies

Exports to the United States account for about 35 per cent of Ontario's Gross Provincial Product (GPP). Accordingly, the health of the U.S. economy is vitally important to Ontario. Following a very rapid initial rebound during the first two years of the recovery, the American economy has settled into a pattern of slow growth. Moreover, despite the stimulus from lower oil prices and falling interest rates, the U.S. economy is expected to remain sluggish.

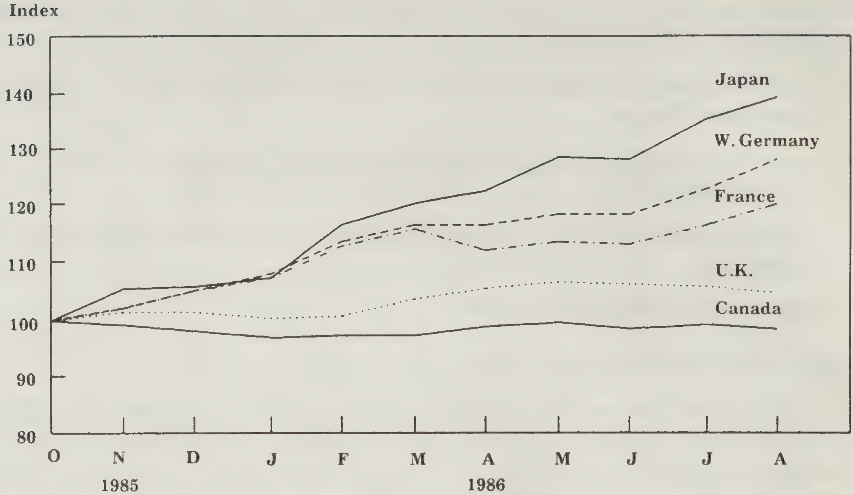
Burdened by a steadily mounting trade deficit, the U.S. economy grew at only a 2.5 per cent real annual rate over the first half of 1986. As a result of a modest pick-up in the second half of 1986, real growth of 2.7 per cent is expected for the year as a whole. While lower oil prices have spurred consumer spending, their short-run negative impacts have been large. Investment spending in the capital-intensive energy sector has collapsed and oil imports are up sharply. The stimulus from recent reductions in U.S. interest rates has been limited to the consumer; business spending is weak.

The trade sector remains the major source of weakness in the U.S. economy. However, there are positive signs. The U.S. dollar has depreciated significantly since the Group of Five (G-5) agreement on exchange rate realignment. For a number of reasons the initial impact has been to widen the trade deficit further this year, but the results of strengthened U.S. competitiveness are expected to be evident in 1987.

In addition to the currency corrections following the G-5 agreement, both West Germany and Japan will have to allow their economies to grow more quickly to absorb U.S. exports. Also, improvements in Third World debt arrangements would facilitate renewed growth of U.S. exports to these countries. This forecast assumes modest improvements on these fronts.

On balance, the U.S. trade performance is expected to improve in 1987; the trade deficit (measured in constant 1982 $) is expected to fall to about $100 billion from $130 billion in 1986.

U.S. DOLLAR EXCHANGE RATES OF MAJOR CURRENCIES
(October 1985 = 100)



Source: Bank of Canada.

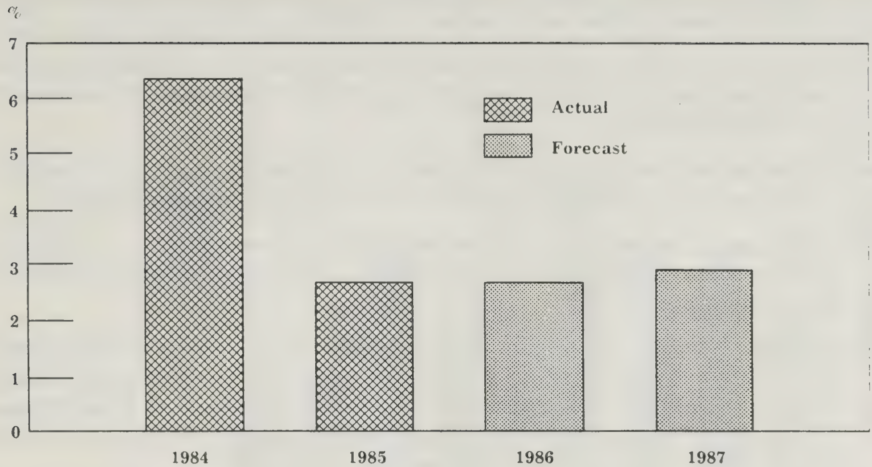
Slow economic growth is producing a record U.S. budget deficit, which is expected to reach close to $230 billion in the current fiscal year. U.S. fiscal policy is expected to become more restrictive in 1987, with or without precise adherence to Gramm-Rudman deficit reduction targets.

- Tax reform could withdraw as much as $11 billion from the economy in 1987, exacerbating the impact of government expenditure restraint on economic growth. In addition, the changes in U.S. tax law shift a greater share of the tax burden to businesses, especially those that are capital intensive. This will have an adverse impact on investment spending.

Monetary policy should continue to play a stimulative role in the economy, providing a partial offset to the trade deficit and tightening fiscal policy. Between January and October 1986, the Federal Reserve Board cut its trend-setting discount rate by 2.0 percentage points, bringing about a significant reduction in short-term interest rates. Further rate reductions are expected next year, providing an incentive to consumer and business spending.

Overall, modest improvement in the trade deficit coupled with further monetary accommodation should produce marginally stronger growth in 1987. Real GNP is forecast to grow at a 2.9 per cent rate. However, tighter fiscal policy and sluggish investment spending will act as impediments to a stronger performance.

U.S. REAL GROWTH



Source: U. S. Department of Commerce and Ontario Ministry of Treasury and Economics.

Continued moderate growth of the economies of other major industrial countries is expected. The current OECD forecast calls for Japanese growth of 3.25 per cent this year, followed by 3 per cent in 1987. The German economy is forecast to expand by 3.5 per cent this year and 3 per cent in 1987. The rest of OECD Europe is expected to achieve growth of 2.75 per cent in 1986 and 2.5 per cent next year.

The Canadian dollar has depreciated significantly against the currencies of Japan, West Germany and France. The recent depreciation of the dollar enhances the competitiveness of Ontario products, both in North American markets and overseas. The Canadian dollar exchange rate against major overseas currencies is not expected to vary significantly from current levels in the short term and thus will continue to contribute to the competitiveness of Canada's trade-sensitive industries. Continued economic growth in these countries should help to sustain Canada's export performance.

The Canadian Economy and Federal Economic Policy

Because of the strong trade links between Ontario and the other provinces, developments elsewhere in Canada have an important bearing on the performance of Ontario's economy. Although interprovincial trade is extremely difficult to measure, Ontario's exports of goods and services to other provinces may account for as much as 15-20 per cent of Gross Provincial Product.

The rest of Canada is expected to grow more slowly than Ontario over the forecast period. Nonetheless, real growth in the rest of Canada is expected to accelerate from 2.4 per cent in 1986 to 3.1 per cent in 1987. Including Ontario, Canadian real GDP is forecast to grow by 3.1 per cent this year and by 3.3 per cent in 1987.

- Canada's unemployment rate is forecast to drop from an annual average of 9.7 per cent in 1986 to 9.4 per cent in 1987.
- Depressed resource prices have dampened growth in the rest of Canada. Large declines in world oil prices have sharply curtailed investment in the oil and gas sector.
- Weak agricultural prices have restrained consumption and business investment in agricultural regions, especially in Western Canada.
- This year's buoyancy in the housing sector is expected to continue in 1987 because of pent-up demand and the possibility of further declines in mortgage rates.
- Export growth is weak this year in response to lower demand growth throughout the international economy, especially for resource products such as metals, oil and agricultural products. However, an improvement in the world's economic environment and modest increases in resource prices should lead to stronger export growth in 1987.

Federal fiscal policy is an important element in the economic outlook. In 1985, federal expenditures of $123 billion amounted to 25.7 per cent of Canada's GDP. Given the relative magnitude of these expenditures, changes in federal spending can have a profound impact on economic performance.

Similarly, federal fiscal policy can affect economic activity through taxation. In 1985, federal revenues, including investment income and CPP contributions, amounted to $92.3 billion or 19.4 per cent of Canadian GDP.

It is assumed for the forecast that the federal government will not alter the fiscal policy stance as announced in the February 1986 budget and reaffirmed in the September statement by the Minister of Finance.

- In the current forecast it is assumed that federal tax and expenditure policies do not change in the 1987-88 fiscal year.

Interest Rates and Exchange Rates

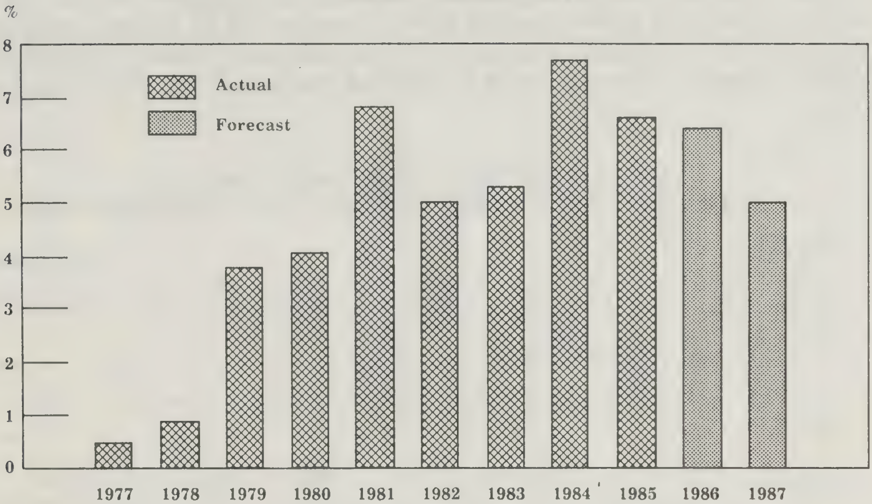
Interest rates are a key determinant of demand for housing, consumer durables and business investment. Recently, interest rates have been declining. After rising to 13 per cent in February 1986, the prime rate fell to 9.75 per cent in July, its lowest level in eight years.

Nominal interest rates are expected to decline further over the forecast horizon. By the end of 1987, the prime rate is expected to decline to 8.5 per cent. This is in line with the expectation of continuing low domestic inflation and further discount rate cuts in the U.S.

Spending is also greatly affected by real interest rates -- that is, nominal interest rates minus the rate of inflation. Real rates have been very high in the 1980s relative to earlier periods. In 1984, the real prime rate was over 7.5 per cent. Given an expected 3.5 per cent rate of inflation, the real prime

rate is expected to fall to 5.0 per cent in 1987. This represents an important stimulus to growth in spending.

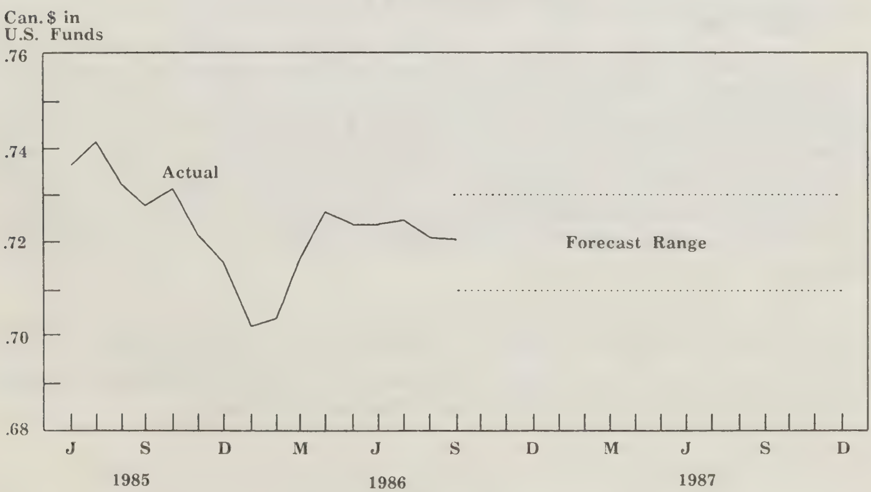
REAL PRIME RATE



Source: Bank of Canada, Statistics Canada and Ontario Ministry of Treasury and Economics.

The movement of interest rates in Canada depends in part on the Bank of Canada's decisions with respect to monetary and exchange rate policies. The Bank of Canada is expected to continue to support the Canadian dollar in the 71-73 cents U.S. range by maintaining, on average, a 100-200 basis point differential between Canadian and U.S. short-term interest rates.

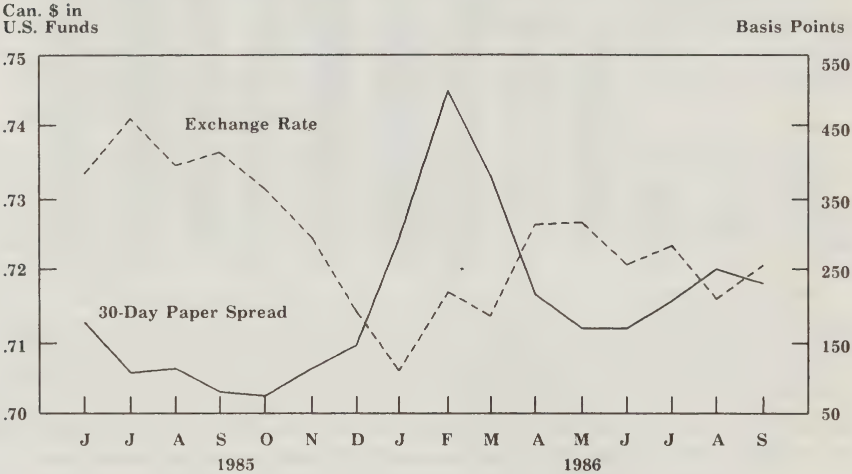
EXCHANGE RATE



Source: Bank of Canada and Ontario Ministry of Treasury and Economics.

The forecast interest rate differential represents a significantly narrower spread than earlier in 1986. At that time, the Bank intervened to support the dollar and raised the interest rate differential to over 500 basis points. This forecast does not anticipate future downward pressure on the Canadian dollar. However, were this to happen, the Bank of Canada would likely once again support the dollar through direct intervention in foreign exchange markets and a widening of Canada-U.S. interest rate spreads. The growth of the Canadian economy would be affected negatively by higher interest rates.

CANADA - U.S. EXCHANGE RATE AND THE
CANADA - U.S. SHORT-TERM INTEREST RATE DIFFERENTIAL



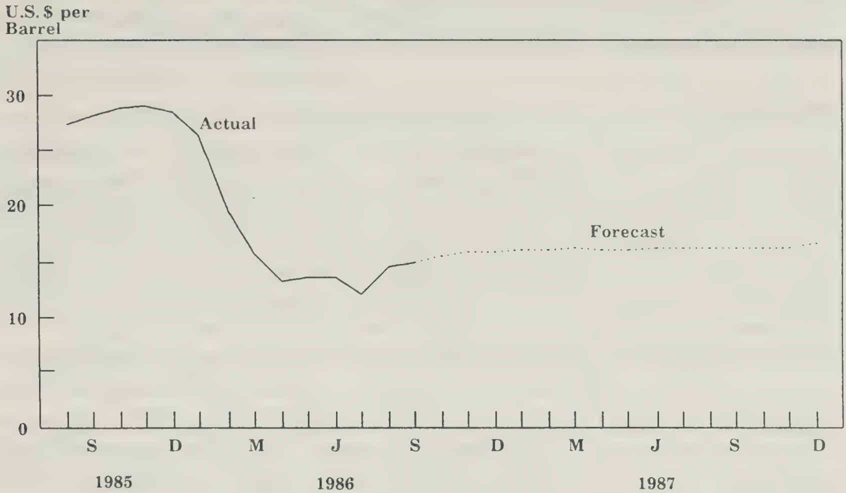
Source: Bank of Canada.

Energy Prices

Over the past decade, sharply higher real petroleum prices led to reductions in demand and the development of alternative sources of energy supply, reducing OPEC's share of world markets and eroding its power to determine prices unilaterally. However, at the end of 1985, in a bid to restore control, Saudi Arabia sharply increased its oil output. This triggered a collapse of world prices from about $28 (U.S.) per barrel at the time to under $10 per barrel in mid-1986. OPEC's agreement in August 1986 to lower output has led again to a firming in prices.

Volatile world oil markets have introduced a large element of uncertainty into economic forecasting. However, world oil prices are expected to reach $16 (U.S.) per barrel by the end of the year. In 1987 and subsequent years, nominal oil prices are assumed to rise in line with inflation.

WORLD OIL PRICES



Source: U. S. Department of Energy and Ontario Ministry of Treasury and Economics.

- The key assumption underlying the expected firming of oil prices is that OPEC's agreement to limit its production will prove durable.

Ontario's oil bill in 1985 was $6.7 billion. The decline in the price of oil to $16 U.S./barrel in 1986 lowers the annual outlay by $2.6 billion. This is an important stimulus to economic activity in Ontario.

Natural gas prices are also falling due to the competitive pressures from refined oil products and government steps to deregulate natural gas markets. Large industrial users of gas have already been able to obtain price reductions of 15 to 30 per cent and lower prices for other gas users are being negotiated. Ontario's wholesale gas bill of $2.8 billion is likely to be reduced by about $500 million annually.

While lower oil prices provide a net stimulus to the Ontario economy, the decline in oil prices has had an adverse effect on growth in the oil-producing regions of Canada. Investment in the energy sector has been particularly hard hit, adversely affecting the demand for some Ontario goods. Similarly, lower oil prices have weakened energy investment in the U.S. and economic performance in its oil-producing regions. This weakens Ontario's exports to those markets as well.

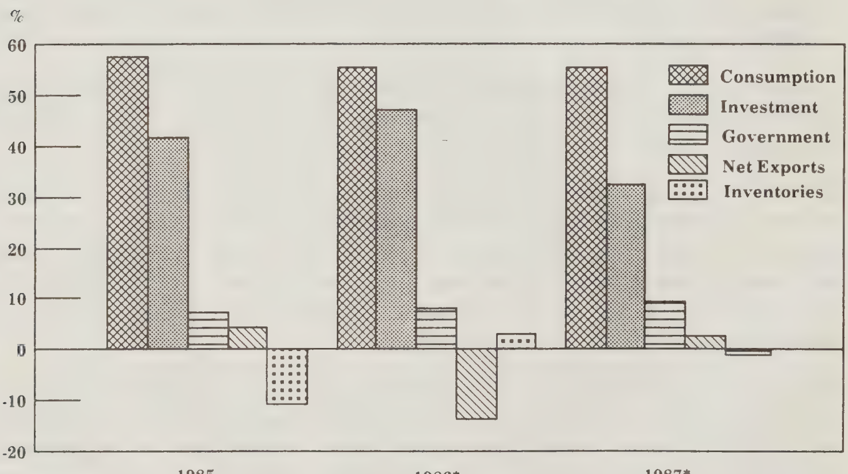
Short-Term Outlook: 1986-1987

Sources of Growth

Overview

The Ontario economy is expected to grow in real terms by 4.1 per cent in 1986 and 3.6 per cent in 1987. In terms of current dollars, the increase of nominal GPP is forecast at 7.1 per cent in 1986 and 6.7 per cent next year. Increases in consumer demand account for over half of the growth in real output in both years. Investment, primarily in residential construction and in machinery and equipment, is expected to generate over 40 per cent of the real growth in output in 1986 and over 30 per cent in 1987. Total government spending will provide a modest additional stimulus to the economy in 1987. After making a small contribution in 1986, inventory accumulation is not expected to be a source of growth in 1987. Net exports will be a drag on growth in 1986 as the increase in imports outpaces the gain in exports. In 1987, the trade position is expected to stabilize with net exports making a small positive contribution to growth.

CONTRIBUTION TO REAL GROWTH



* Forecast

Source: Ontario Ministry of Treasury and Economics.

Consumer Demand

Consumer spending, which represents over half of aggregate spending, will be the main contributor to sustained expansion. In particular, the consumption of durables will remain robust. Personal expenditures on all goods and services are forecast to grow by 4.1 per cent and 3.7 per cent in real terms during 1986 and 1987 respectively.

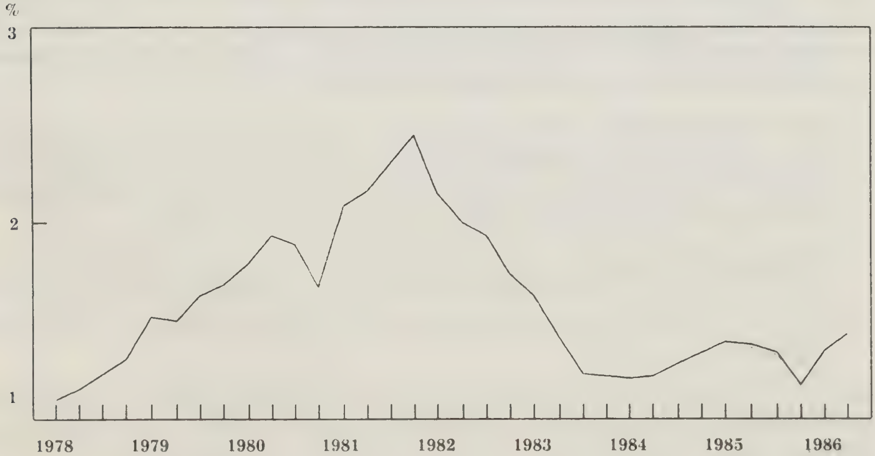
Due to low inflation, declining unemployment and falling interest rates, consumer confidence is expected to remain firm. This is particularly true for Ontario since it is much less vulnerable than other parts of Canada to the

negative side effects of low oil and commodity prices. According to the 1986 summer consumer survey by the Conference Board of Canada, the Ontario index of consumer attitudes climbed to 132.4 in the second quarter of 1986, up from 121.1 in the first quarter.

There are a number of factors that will influence consumer expenditures in the short term:

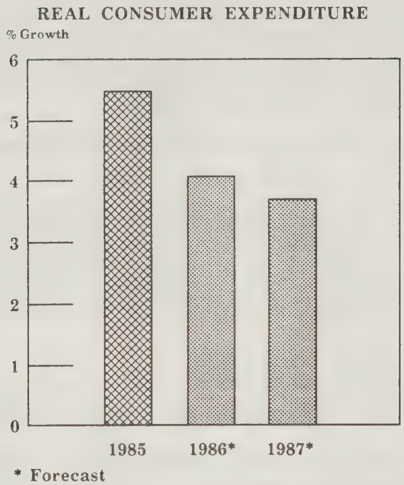
- There will be a modest deceleration in nominal personal income growth, to 7.8 per cent in 1986, down from 8.2 per cent in 1985. This reflects the impact of a decrease in deposit rates on interest income and a higher concentration of job creation in the lower-paying service sector. Growth in personal income will slow further to 7.3 per cent in 1987.
- Real personal income will continue to rise, posting a 3.7 per cent gain in both 1986 and 1987.
- The higher federal personal income tax rates that came into effect this year will tend to dampen expenditure growth, but this is expected to be cushioned by the impact of low oil prices and a declining savings rate. Real personal disposable income is forecast to grow by 2.5 per cent this year and by 3.4 per cent in 1987.
- The Ontario personal savings rate, which averaged 17.2 per cent in 1985, is expected to decline to 15.9 per cent in 1986 and 15.6 per cent in 1987.
- A strong housing market, along with declining interest rates, should sustain robust demand for consumer durables such as furniture and appliances.
- With credit interest payments remaining relatively moderate as a per cent of personal disposable income, consumers are in a good position to take on more debt.

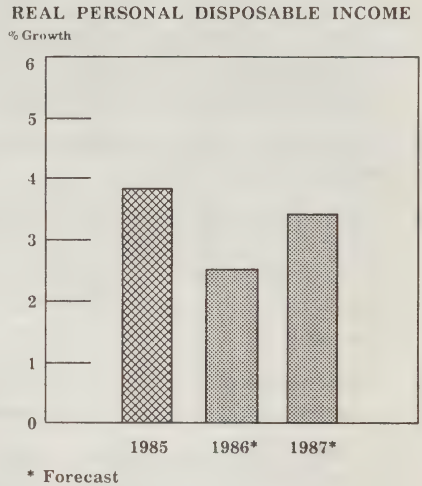
CREDIT INTEREST PAYMENTS AS A SHARE OF PERSONAL DISPOSABLE INCOME



Source: Statistics Canada.

Retail sales, which represent about 45 per cent of personal consumption on goods and services, are forecast to grow by 8.1 per cent this year and by 7.0 per cent next year. Significant gains are occurring in sales of household appliances, furniture and home entertainment products. The strong growth in sales of these particular goods is due, to a significant extent, to the buoyant housing market.





Source: Ontario Ministry of Treasury and Economics.

Housing

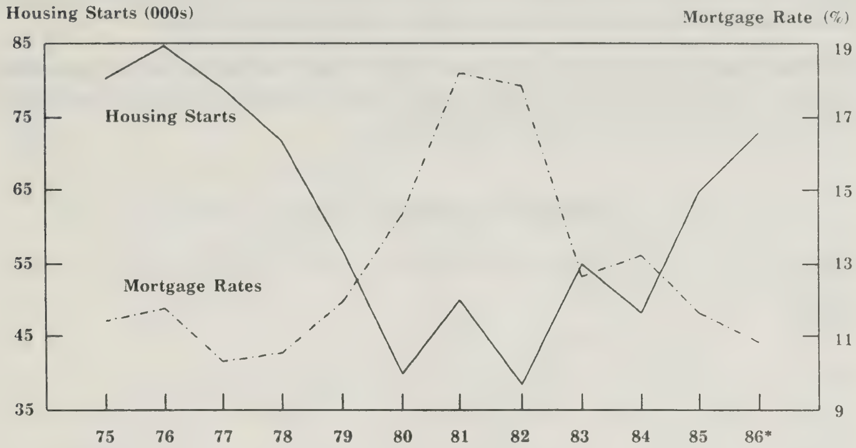
Buoyancy in the housing sector will persist for the remainder of 1986 and continue into 1987. Residential construction, which includes renovation activity, is expected to be a major contributor to growth. Accordingly, residential investment is expected to climb by over 20 per cent in 1986 and grow at a somewhat slower rate of 13.5 per cent in 1987. Falling mortgage interest rates, pent-up demand from the earlier period of record-high interest rates and the expectation of further significant housing price increases have led to a surge of buying in Ontario.

- Over the first eight months of 1986, housing prices for new homes in Kitchener-Waterloo and Metro Toronto rose 16.0 and 12.6 per cent, respectively, from last year, while housing starts for Kitchener-Waterloo and Metro Toronto rose 47.5 and 27.9 per cent, respectively.

- Shortages of materials and skilled labour have delayed construction of many new homes until 1987. The shortage of new homes, combined with delayed closing dates in that market, has spurred growth in the resale market.

Ontario housing starts are expected to reach 73,000 for 1986. The pace of activity will pick up in 1987, with housing starts rising to an estimated 77,000 units.

ONTARIO HOUSING STARTS AND MORTGAGE RATES



* Forecast

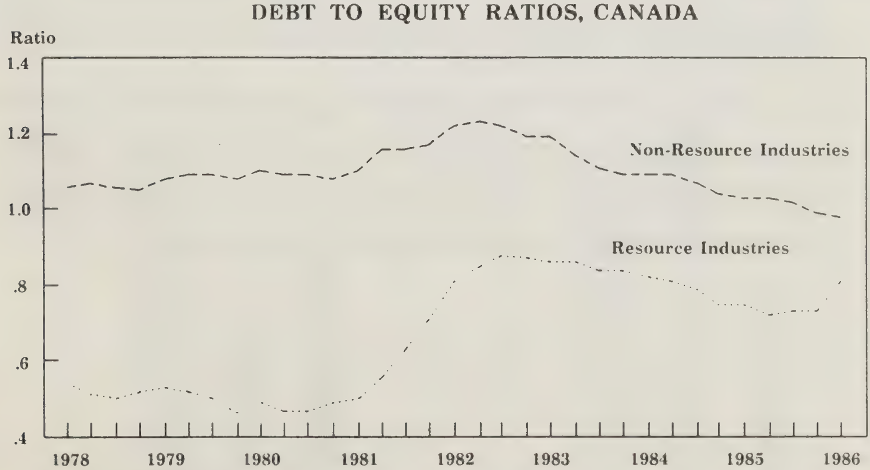
Source: Canada Mortgage and Housing Corporation.

Business Investment

Business investment in plant and equipment is expected to be a major contributor to growth in Ontario in both 1986 and 1987. A strong competitive position, improvements in corporate balance sheets since the recession, the recovery of corporate profits, improved business confidence in the sustained expansion of the economy and declining interest rates have combined to create a very favourable climate for investment.

Corporate profits are forecast to grow by 7.5 per cent in 1986 and a further 6.1 per cent in 1987.

DEBT TO EQUITY RATIOS, CANADA

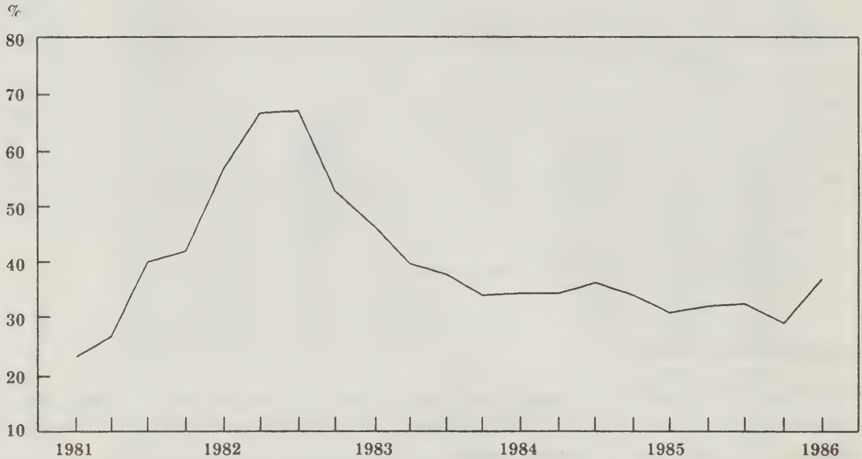


Source: Statistics Canada.

The recovery of profits, the reduction in debt payments due to lower interest rates, and the rapid fall in inflation have led to an improvement in the health of the corporate sector. Debt to equity ratios have fallen more quickly in the non-resource sector than in the resource sector.

Simultaneously, the interest service ratio, which reflects interest payments as a percentage of cash flow, has been falling because of improvements in corporate incomes and lower debt charges.

INTEREST SERVICE RATIO, CANADA

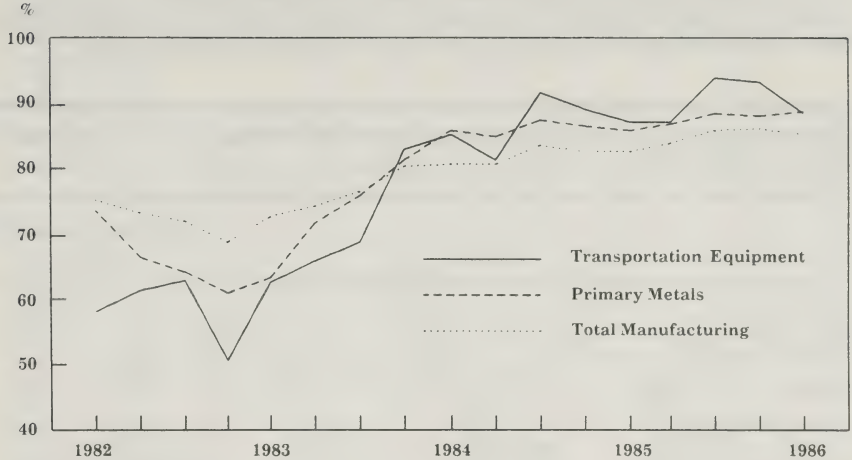


Source: Statistics Canada.

Although capacity utilization rates remain low by historical standards, they have been moving upwards. The current investment expansion reflects the fact that many sectors are reaching the limit of their useable capacity.

- Capacity utilization across all goods-producing industries, excluding energy, stood at 79.9 per cent in the first quarter of 1986, 13.8 percentage points higher than at the lowest point during the recession.
- The manufacturing sector was estimated to be operating at 85.6 per cent capacity during the first quarter of 1986, 16.9 percentage points higher than at the lowest point during the recession. Utilization has been running at higher rates in the transportation equipment and primary metal industries. These industries are expected to account for much of the growth in capital spending in the manufacturing sector.

CANADIAN CAPACITY UTILIZATION RATES
FOR SELECTED MANUFACTURING INDUSTRIES

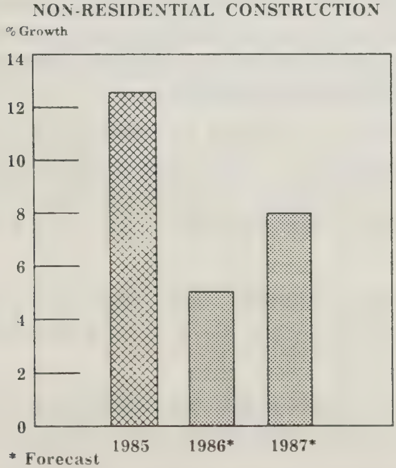


Source: Bank of Canada.

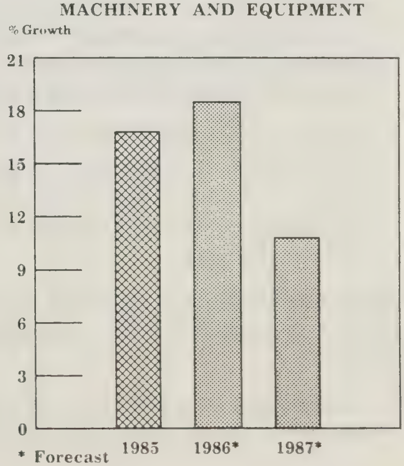
Although factors such as interest rates, inflation and corporate profits are important in the investment decision, the single most important determinant of investment is the outlook for sales. In this regard, demand growth is expected to remain firm, thereby providing the main impetus for continued strength in business investment.

- Total business non-residential investment will post a 13.6 per cent increase in 1986, and a further 9.8 per cent in 1987.
- Investment in non-residential structures will increase moderately, expanding by 5.1 per cent in 1986 and 8.0 per cent in 1987.
- Machinery and equipment spending will make the largest contribution to growth in business non-residential investment, expanding 18.5 per cent this year. The pace of activity will be slower in 1987 but machinery and equipment investment is still expected to advance by a solid 10.8 per cent.

NON-RESIDENTIAL CONSTRUCTION



MACHINERY AND EQUIPMENT



Source: Ontario Ministry of Treasury and Economics.

Exports and Imports

Ontario's trade performance depends, to a large extent, on developments in the United States which is by far our most important trade partner.

Ontario Merchandise Export and Import Shares, by Country, 1985 **Table 2**

	Exports	Imports
	% of Total	
United States	90.8	83.4
United Kingdom	1.5	1.7
Japan	0.8	3.2
West Germany	0.6	1.7
Other Countries	6.3	10.0
All Countries	100.0	100.0

Source: Statistics Canada and Ontario Ministry of Industry, Trade and Technology.

After being the engine of growth in the early years of the recovery, trade is currently a drag on economic growth. Imports are rising more rapidly than exports, resulting in declining net exports.

- Weak export growth in 1986 is due to sluggish economic performance in the U.S. In addition, slower growth in the rest of Canada, partly because of low oil prices, will limit the advance of Ontario's interprovincial exports.
- The U.S. market for new cars and light trucks is not expected to repeat gains made in 1984 and 1985. Nonetheless, as a result of the product mix of the Ontario auto industry, some further modest increases of its exports to the U.S. are expected. While the auto sector will be a less important source of export growth, underlying strength in replacement demand is expected to ensure no drastic reversal for the industry.
- Ontario's spending on imports is being boosted by the spending on investment in machinery and equipment, which has a high import content. Spending on foreign-made consumer durables is also strong. Spending for energy imports will decline substantially due to the recent fall in oil prices.

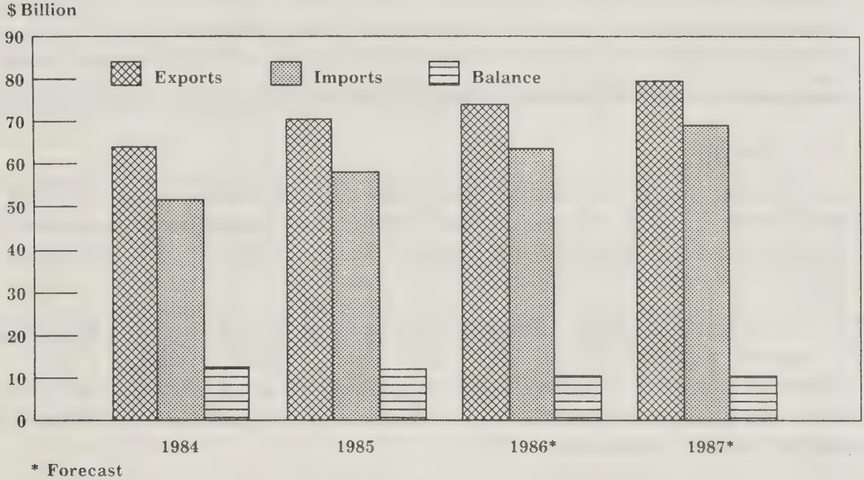
The trade balance is expected to improve in 1987. More rapid growth in exports is expected to be accompanied by moderation in the growth of imports.

- As changes in trade flows typically lag exchange rate adjustments, the impact of the depreciation of the Canadian dollar against European and

Japanese currencies will not become apparent until 1987. This will enhance the competitiveness of Ontario's exports overseas, and improve Ontario's competitiveness in the U.S. market against exports from other countries.

- In addition, low oil prices will directly contribute to a larger trade surplus by reducing Ontario's energy import bill. They should also result in healthy growth in consumer spending in the United States, leading to increased demand for Ontario exports.

ONTARIO TRADE POSITION



Source: Ontario Ministry of Treasury and Economics.

Labour Markets

Overview

Continued economic growth will result in further employment creation and a falling unemployment rate. The Ontario economy is expected to create 156,000 jobs in 1986 and 114,000 in 1987. The unemployment rate is expected to drop from a 1986 average of 7.0 per cent to 6.7 per cent in 1987, as growth in employment outpaces increases in the labour force.

Ontario Labour Market Outlook **Table 3**

	1985	1986 (000s)	1987	1985	1986 (percentage growth)	1987
Labour Force	4,787	4,899	5,010	2.6	2.3	2.3
Employment	4,402	4,558	4,672	3.7	3.5	2.5
Job Creation	159	156	114	-	-	-
Unemployment	385	341	338	-	-	-
Unemployment Rate (%)	8.0	7.0	6.7	-	-	-
Participation Rate (%)	68.0	68.5	69.1	-	-	-

Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

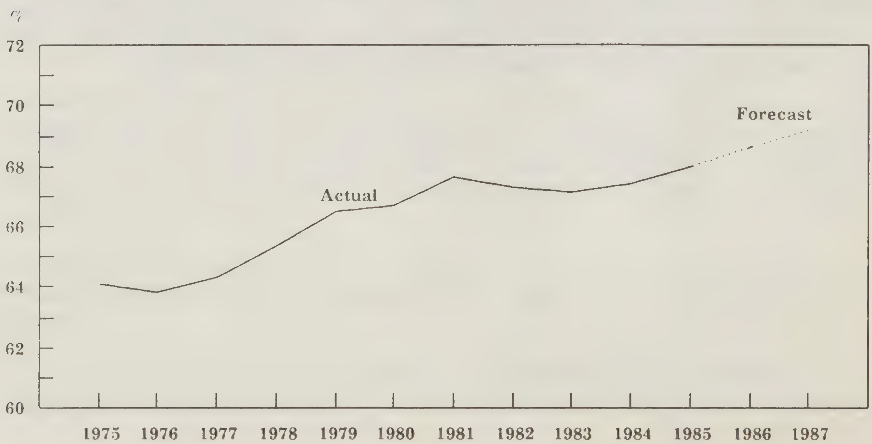
Labour Supply

Both population growth and participation rate increases will contribute to labour force growth. Ontario's labour force is expected to increase by 112,000, or 2.3 per cent, in 1986, and by a further 111,000, or 2.3 per cent, in 1987.

There will continue to be substantial growth in the 15 and over age group, the source population for the work force. This is due, in part, to interprovincial and international migration. Significant net inflows of people can be expected as a result of Ontario's strong economic performance relative to other provinces.

Ontario's labour force will also be affected by increases in the rate of participation in the labour force. In the short-run, participation rates are affected by labour market conditions. As labour markets deteriorate, participation rates fall. For example, participation rates decreased in 1982 and 1983 in response to rising unemployment. Conversely, rates tend to increase as labour markets tighten.

ONTARIO PARTICIPATION RATE



Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

There is also a long-run trend of increasing labour force participation. The labour force participation rate in Ontario increased by 3.9 percentage points from 1975 to 1985. Two major factors have been the trend increase in women's participation rates and the changing age composition of the population.

- Women's participation rates have increased from 48.6 per cent in 1975 to 57.9 per cent in 1985. This growth is expected to continue, but at a decelerating rate.
- The 15 to 24 year old age group peaked in 1980, at 24.3 per cent of the source population. This share dropped to 21.7 per cent in 1985. Youth will continue to decline as a proportion of the source population, while the prime age group, 25 to 44 years of age, will increase. The prime age group has a higher participation rate than youth, and will continue to exert upward pressure on the aggregate participation rate.

Employment

Job creation is forecast at 156,000 this year, and a further 114,000 in 1987.

Job creation will continue to be concentrated in the service industries both this year and next. In the goods-producing industries, manufacturing and construction will remain significant contributors to employment growth. The private sector accounted for 140,000 or 88.1 per cent of the jobs created in 1985, and will continue to dominate job creation in 1986 and 1987.

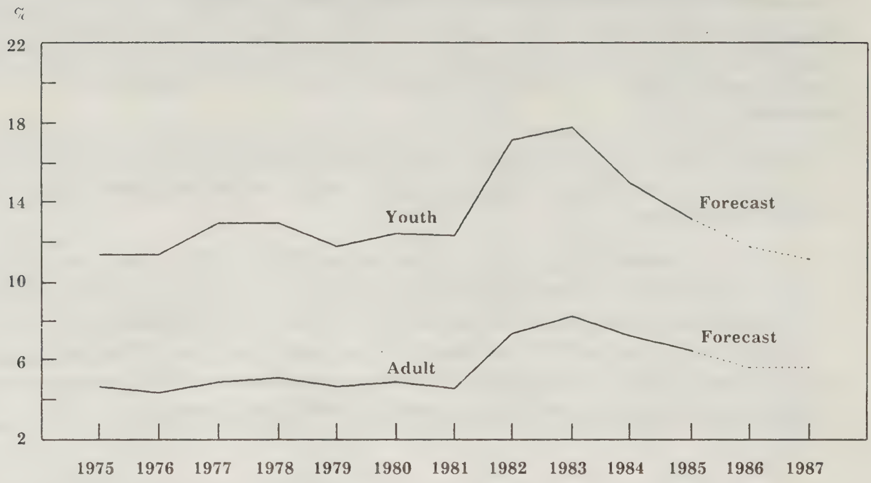
Most of the jobs created so far in 1986 have been full time. Indeed since the end of the recession, full-time employment has grown more strongly than part-time employment, in contrast to the experience of the late 1970s and early 1980s. Part-time employment in Ontario accounts for about 16 per cent of total employment. This is slightly higher than in the rest of Canada, but two percentage points lower than the comparable figure in the United States.

Unemployment

Employment growth is forecast to continue to outpace growth in the labour force, resulting in a decline in both the number of people unemployed and the unemployment rate.

Unemployment rates for youth continue to be higher than those for adults. Both rates peaked in 1983, the youth unemployment rate at 17.8 per cent and the adult rate at 8.1 per cent. Neither unemployment rate has yet returned to its pre-recession level, although the youth unemployment rate is expected to do so this year.

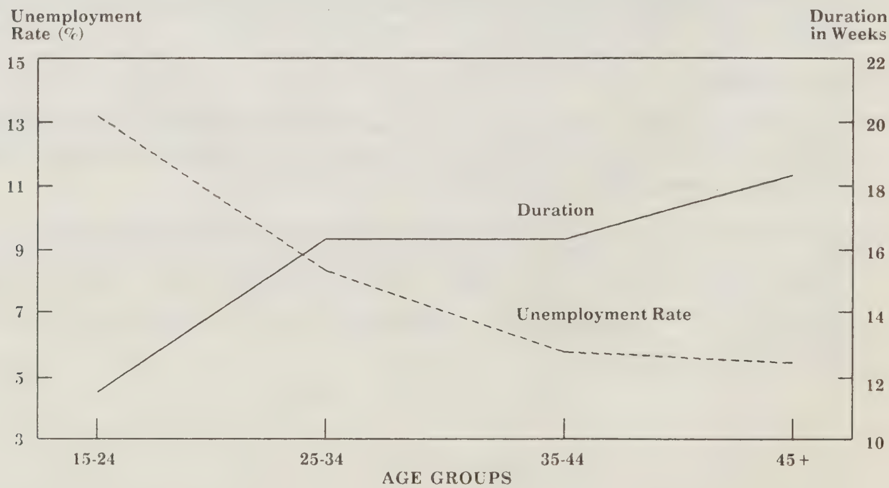
YOUTH AND ADULT UNEMPLOYMENT RATES



Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

While youth have relatively high rates of unemployment, the incidence of long-term unemployment is lower for young people than for other age groups. Older workers, while typically having the lowest unemployment rates, are more likely to experience longer-term unemployment once they lose their jobs. In 1985, the duration of unemployment among older workers averaged 18.3 weeks compared to 11.5 weeks for youth.

ONTARIO UNEMPLOYMENT RATES AND AVERAGE DURATION OF UNEMPLOYMENT, 1985



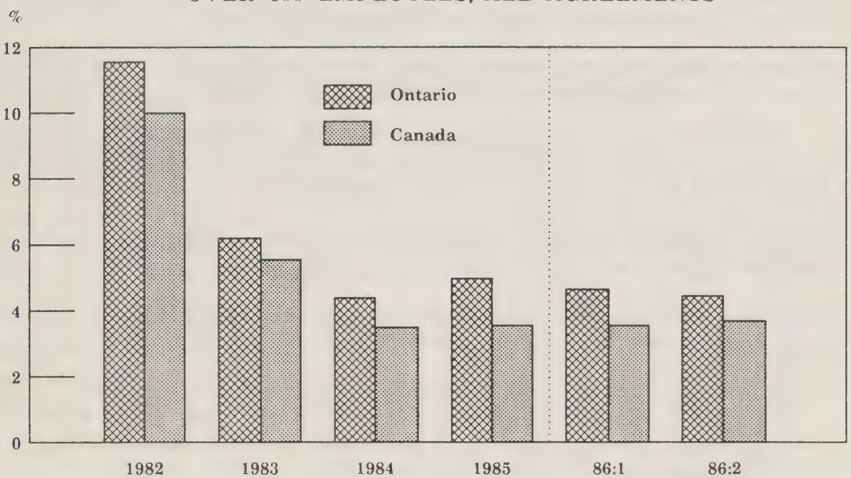
Source: Statistics Canada.

Wages

Wage increases have remained moderate since the end of the recession. Average industrial wages in Ontario rose by 4.6 per cent in 1985. This translated into an average real wage increase of 0.6 per cent.

- In Ontario, collective bargaining settlements without cost-of-living-adjustment (COLA) averaged 5.0 per cent in 1985. In the first half of 1986, they averaged 4.5 per cent.
- Data for the country as a whole indicate somewhat lower wage gains in the rest of the country. 1985 settlements without COLA averaged 3.6 per cent across Canada. So far in 1986, they are averaging 3.7 per cent.
- Private sector wage settlements have generally been below public sector settlements. In 1985, Canadian settlements in the private and public sectors averaged 3.1 per cent and 3.8 per cent, respectively. In Ontario, settlements averaged 4.3 per cent for the private sector and 5.1 per cent for the public sector.

NON-COLA WAGE SETTLEMENTS
OVER 500 EMPLOYEES, ALL AGREEMENTS

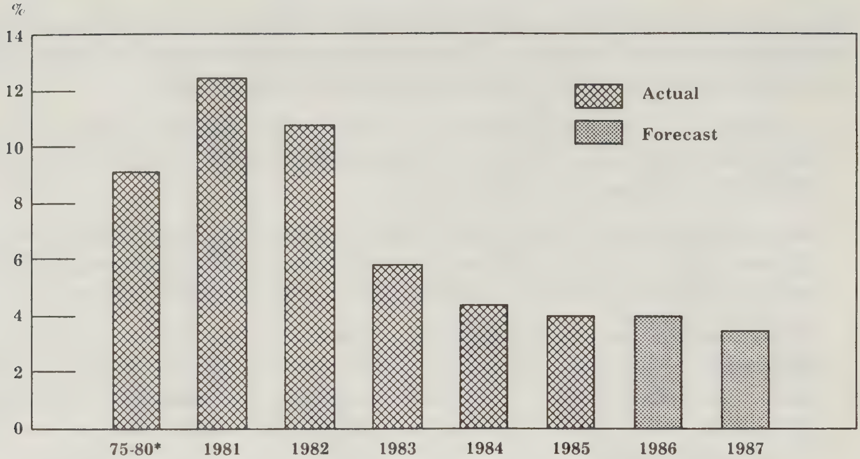


Source: Labour Canada.

Inflation

One of the more striking differences between the economy of the late 1970s and the economy of the mid-1980s is the markedly lower rates of inflation. Consumer price inflation fell from 12.5 per cent in 1981 to 4.0 per cent in 1985, the lowest rate since 1971. The recent decline in oil prices should consolidate the lower levels of inflation. Only moderate inflation is anticipated in the outlook period. The Consumer Price Index is expected to rise by 4.0 per cent in 1986 and by 3.5 per cent in 1987.

CONSUMER PRICE INFLATION



* Annual Average

Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

Falling oil prices, coupled with weak agricultural prices, have been placing downward pressure on Canada's inflation rate in 1986.

- The energy cost component of the Consumer Price Index fell by 12.1 per cent between September 1985 and September 1986.
- Agricultural product prices are also weak. In Ontario, farm prices of agricultural products fell by 2.9 per cent in the first half of 1986 compared to the same period a year earlier.

The main sources of upward pressure on Canada's inflation rate in 1986 have been increases in indirect taxes and in the price of services.

- It is estimated that federal tax hikes will have added 1.0 to 1.5 percentage points to the increase in the Consumer Price Index this year.
- Service prices have risen by an average of 5.0 per cent to date this year, compared to only 3.9 per cent in 1985. This acceleration has been driven to a large extent by the rapid increases in insurance premiums and housing prices.

In 1987, the inflationary impact of the increases in indirect taxes will have worked its way through the system. It is assumed that there will be no further increases in indirect taxes, aside from those already announced. Other factors will also contribute to low inflation.

- Raw materials will continue to face oversupply on world markets, exerting downward pressure on inflation. However, it is expected that there will be a modest firming of raw material prices from their current low levels.
- There is still sufficient excess capacity that continued economic expansion expected in 1987 can be accomplished without exerting upward pressure on prices.
- Prices of imported goods are expected to remain relatively stable.

Medium-Term Outlook: 1988-1990

Introduction

This section provides a projection of the performance of the Ontario economy beyond 1987 to the end of the decade. It is important to note that these projections are not targets; nor are they to be regarded as necessarily an acceptable economic performance. Moreover, unlike the short-term forecast, this is not a forecast of cyclical movements in output or employment. It is an attempt to indicate how large the economy will be by 1990, given certain reasonable assumptions about the external environment.

Overview

Ontario is projected to sustain its improved economic performance at least to the end of the decade. There are several key assumptions that underlie this expectation:

- Energy prices will increase only modestly.
- Real interest rates will continue to trend down.
- The Canadian dollar will not appreciate sharply relative to the U.S. dollar.
- The international economy will continue to expand, with a more balanced performance amongst the U.S., Europe and Japan.
- Significant increases in U.S. protectionism will be avoided.*

Table 4 summarizes the forecast for 1988-1990. The graphs that follow compare the forecast performance for the medium term with preceding periods. They indicate a significant improvement in the economic outlook relative to the past decade.

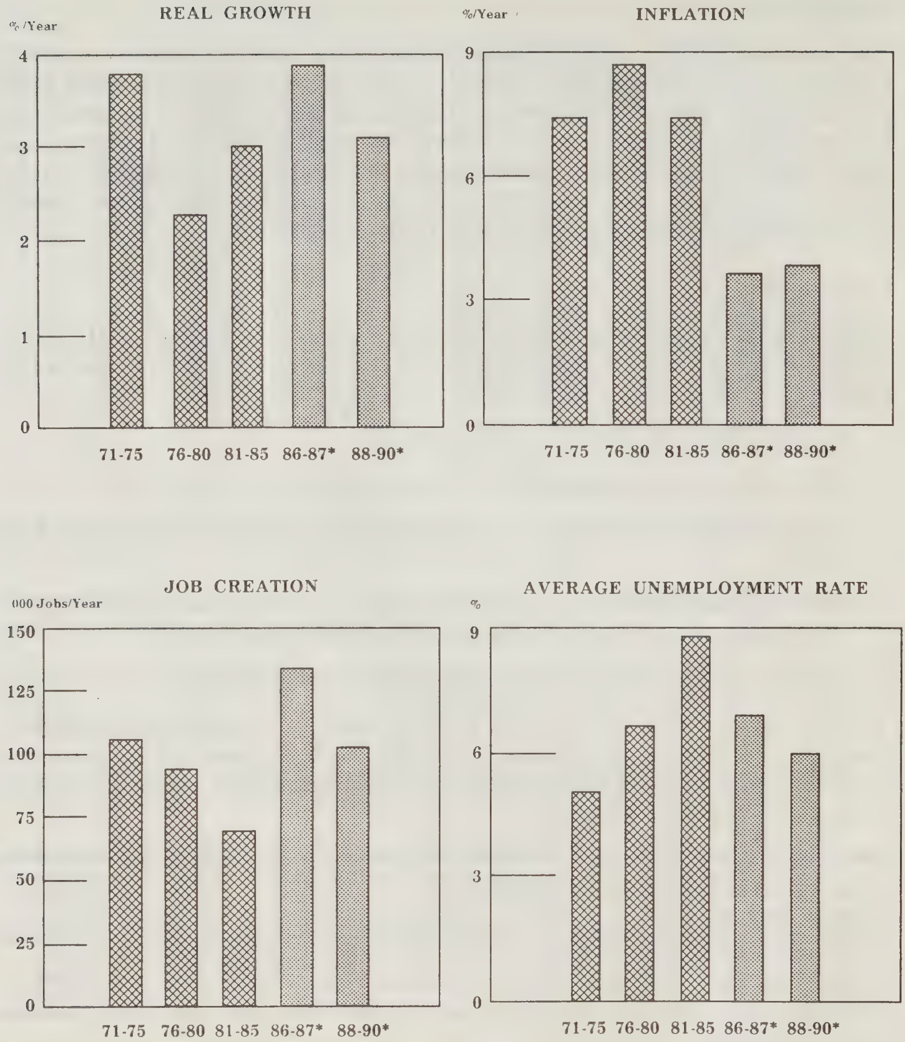
The Ontario Economy: 1988-1990 **Table 4**
(Annual Average)

	Base Case
Real Growth (%)	3.1
Inflation (%)	3.9
Job Creation (000s)	103
Unemployment Rate in1990 (%)	5.5

Source: Ontario Ministry of Treasury and Economics.

* A free trade agreement with the United States has not been assumed in the medium-term outlook.

ONTARIO'S MEDIUM-TERM OUTLOOK



* Forecast

Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

Key Factors in the Medium Term

The U.S. and World Economy

Over the remainder of the decade, 1988-90, the U.S. is projected to achieve moderate real growth averaging 3.0 per cent annually. U.S. budget deficit reduction is assumed to proceed in step with declining interest rates in the U.S. and continued low inflation. This results in steady growth of consumption and investment. The U.S. trade position is expected to improve

gradually, further supporting growth. This will be partly the result of better balanced and sustained growth in the world economy.

The Rest of Canada

From 1988 through 1990, growth across Canada is expected to be more evenly distributed. Moderate growth in the world economy should help firm resource prices and stimulate growth in the rest of Canada.

Financial Markets

Beyond 1987, real interest rates are assumed to trend down to historically more normal levels, reaching near 3.5 per cent by 1990. The exchange rate against the U.S. dollar is expected to appreciate gradually to 75¢ by 1990.

Oil Prices

Oil prices are expected to be stable in real terms over the medium term. Current low prices will induce some marginal producers to leave the market. They will also, over time, encourage more consumption of oil products. However, to a large extent, the increased efficiency in energy use that came about during the period of high energy prices is irreversible. Consequently, demand is unlikely to rise sharply.

Sources of Growth

Consumption

Medium-term prospects for consumer spending are very positive.

- Employment increases and real wage growth will raise real purchasing power.
- Savings rates will continue to decline from their present high level as inflation moderates and as uncertainty about economic prospects diminishes.
- Interest rates on consumer loans and mortgages will decline over the period.
- An increasing proportion of the population is in the 25 to 40 year-old age group, with its attendant high consumption of durable goods. In addition, the number of two-earner families will continue to rise. These demographic factors, in combination with the weak performance in the early 1980s, suggest the existence of strong potential demand.

Housing

Between 1988 and 1990, the formation of roughly 62,000 net new households per year can be expected. Also, there is some pent-up demand from the first half of the 1980s, when almost 70,000 new households were formed each year on average while housing starts averaged 49,500. In conjunction, these factors should result in expenditure on housing remaining strong. Given the favourable interest rate climate and a healthy

labour-market outlook, housing starts are expected to average between 71,000 and 75,000 per year.

Investment

The current rapid growth rates for investment spending are likely to moderate over the balance of the decade. After 1988, investment spending is expected to increase in tandem with the overall growth of the economy.

Investment will be supported by reasonably strong domestic demand, stronger corporate balance sheets reflecting the low inflation rate and further declines in interest rates, rising capacity utilization and further improvements in corporate profits.

Investment in machinery and equipment should continue to grow more rapidly than capital spending on non-residential construction.

Trade

Ontario's trade balance is expected to improve over the medium term. A sustained and balanced increase in the growth of the world economy, coupled with the maintenance of Ontario's competitive position, will continue to encourage export growth.

Imports during 1988-1990 will grow less rapidly than in 1986-1987. This results from more moderate growth in Ontario's economy. However, import growth will still remain substantial, reflecting the healthy growth in both consumer demand and business investment in machinery and equipment.

Employment, Productivity and Inflation

Employment and Labour Force

The Ontario economy is projected to generate 103,000 new jobs per year over the years 1988-90. Employment is expected to grow at an average annual rate of 2.2 per cent while the labour force is expected to grow at a 1.7 per cent average annual rate. The unemployment rate is forecast to drop to 5.5 per cent in 1990.

Growth of the labour force will slow over the forecast period. This reflects a marked slowdown in the growth of the over-15 population. This slowdown is only partially offset by an increasing participation rate. The age composition of the labour force will change over the forecast period. Despite increasing participation rates, the size of the youth labour force will be about 50,000 lower in 1990 than in 1985.

Productivity

Productivity growth is a crucial factor in the economic outlook affecting international competitiveness, job creation and real income growth. Output per employee is projected to rise by 1.0 per cent per year over the forecast horizon. This would be a significantly better result than the provincial economy achieved in the 1970s, but is in line with more recent experience.

Between 1973 and 1980, output per employee in Ontario fell by 5.9 per cent. This decline reflected: energy price shocks, high inflation, low capacity utilization, slower capital formation, and rapid growth of the labour force.

These factors are not expected to be important in the outlook period. A better trend in productivity growth should be supported by:

- stable energy prices;
- low inflation;
- stronger capital formation in manufacturing and services;
- slower labour force growth; and
- maturing of the labour force .

ONTARIO PRODUCTIVITY PERFORMANCE
(Compound Annual Growth Rates)

Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

Inflation

Moderate inflation is expected to continue, with CPI increases averaging 3.9 per cent over the period 1988-90. Monetary policy in the major industrial countries, including Canada, is expected to be aimed at maintaining stable prices.

Population

In the 1988-1990 period, Ontario's population will grow by 1.1 per cent per year, compared to the 1.2 per cent per year that occurred in the period 1982 - 1985. The actual increase between 1987 and 1990 will be 304,000 people, with Ontario's population rising to 9,593,000. Around 60 per cent of expected growth will be due to the excess of births over deaths. Ontario is expected to experience continued population gains as a result of

interprovincial migration. In addition, Ontario will benefit from a moderate increase in net international migration.

The only age group to experience a decline in the 1988-1990 period will be young adults aged 15-24, whose numbers will decline by 7.3 per cent. The elderly population will grow by 105,000 or 10.1 per cent, with almost half this growth among those 75 and over. By 1990, the 65 and over age group will account for 12.0 per cent of Ontario's population compared to 10.7 per cent in 1985.

Ontario Population By Age Group: 1985, 1987 and 1990 **Table 5**
(Thousands)

	Population			
	1985	1987	1990	1990/1987 (% change)
0-4	626	651	666	2.3
5-14	1,258	1,248	1,272	1.9
15-24	1,553	1,508	1,398	-7.3
25-39	2,258	2,345	2,459	4.9
40-49	1,047	1,137	1,278	12.4
50-64	1,348	1,358	1,373	1.1
65-74	584	626	680	8.6
75+	386	416	467	12.3
TOTAL	9,060	9,289	9,593	3.3

Source: Ontario Ministry of Treasury and Economics.

Note: Data for 1985 are estimates and data for 1987 and 1990 are forecasts.

Sector Outlook

Overview

For the past five years, Ontario's growth in output has been based primarily on improvements in the auto and service sectors. For the next five years, Ontario's performance will be stronger and will reflect more balanced growth as other sectors are expected to show higher growth rates than earlier. Growth will be led by the construction industry, especially in 1986 and 1987, reflecting strong increases in residential construction. Above average growth will also continue to be experienced by the transportation equipment industry. The primary sector and resource-based industries, while improving on their 1981-85 performance, will show the least growth; slow growth in world demand for their products will persist. In keeping with its past performance, the service sector will be a source of higher than average growth over the forecast period.

Sector Outlook for Ontario — **Table 6**

	Real Output (Annual % Change)	
	1981-85	1986-90
Primary	0.2	1.6
Manufacturing	2.4	3.1
Resource-Based Manufacturing	0.8	2.4
Transportation Equipment	10.2	3.6
Other Manufacturing	1.4	3.3
Construction and Utilities	2.7	4.2
Service Sector	3.3	3.6
Total	2.9	3.4

Source: Conference Board of Canada and Ontario Ministry of Treasury and Economics.
Note: Industries included in each sector are enumerated in sections below.

Unit Labour Costs

The strength of Ontario's economic outlook, including continued growth in exports, in part reflects improvements in Ontario's competitive position in the U.S. market. A significant factor has been the decline in Canada's unit labour costs, measured in U.S. dollars, relative to those in the United States.

In the late 1970s and early 1980s strong resource prices led to rapid domestic inflation, increased strike activity and high wage settlements relative to the United States. This was partially offset by currency depreciation. In turn, since 1982 the weaker resource sector has moderated domestic inflation and wage settlements throughout the economy. Lower

resource prices have also weakened the Canadian dollar, further adding to the improved relative cost performances in Canada.

Between 1981 and 1985, unit labour costs rose by 12.4 per cent in the U.S. and 19.8 per cent in Canada.

However, when exchange rate movements are taken into account, unit labour costs in Canada -- measured in U.S. dollars -- increased by only 5.2 per cent over the same period. During 1984 and 1985, exchange rate adjusted Canadian unit labour costs declined by a total of 5.2 per cent, primarily resulting from a depreciation of nearly 10 per cent in the Canadian dollar.

Canada-U.S. Unit Labour Costs, 1981-1985 **Table 7**
(Per Cent Change from Previous Year)

	1981	1982	1983	1984	1985
United States	8.7	7.0	0.5	1.2	3.4
Canada	12.5	11.9	1.9	2.4	2.6
Canada*	9.7	8.7	2.0	-2.6	-2.7

Source: Bank of Canada and U.S. Department of Labor.
* Exchange rate adjusted to express Canadian costs in terms of U.S. dollars.

- The substantial depreciation of the Canadian dollar against major European currencies and the Japanese yen since the G-5 agreement in September 1985 should make Ontario's exports more competitive, not only in Japan and Western Europe, but also in the important U.S. market.

The forecast anticipates no significant change in relative unit labour costs over the forecast horizon.

Business Investment

An indication of the combined effects of stronger demand and increased competitiveness is provided in this year's investment intentions of business in Ontario.

- Investment in manufacturing will account for about two-thirds of the expansion in total business investment in 1986. Substantial increases in investment are expected in the transportation equipment industries, essentially autos, followed by the metal fabricating and machinery industries.
- Investment in commercial services and in the retail and wholesale trade sector will be quite robust. A healthy expansion is also expected in both the finance and construction sectors.

- Investment is expected to be much stronger for machinery and equipment than for non-residential construction, due to business use of new technology to improve productivity.

Share of Ontario Non-Residential Business Investment **Table 8**

	1985	1986
	(per cent)	
Agriculture & Fishing	5.6	3.4
Forestry	0.2	0.2
Mining, Quarrying & Oil Wells	3.2	2.5
Manufacturing	29.0	33.8
Construction	2.2	2.2
Utilities	27.4	24.7
Trade	4.9	5.0
Finance, Insurance & Real Estate	13.2	13.1
Commercial Services	14.3	15.1
Total Business Investment	**100.0**	**100.0**

Source: Statistics Canada.

Primary Sector Outlook

Following modest increases in real output in 1985, agriculture, mining and forestry are expected to show further gradual increases in the next five years.

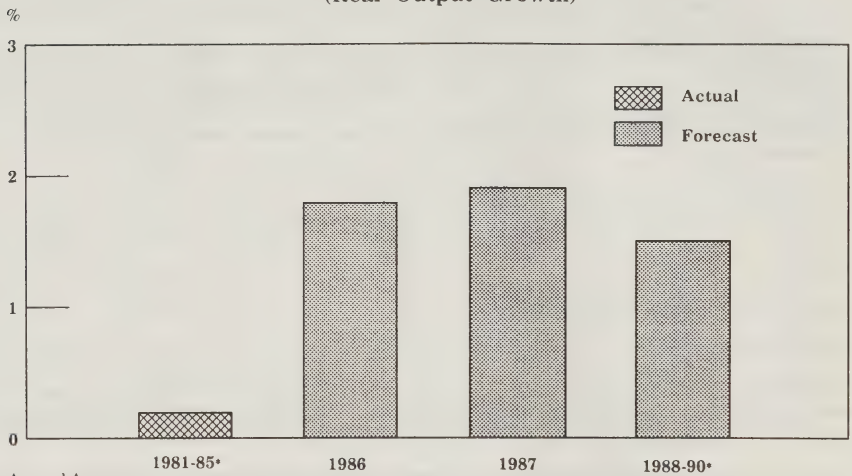
The outlook for Ontario's relatively diversified agricultural sector is for real output growth of about 1.5 per cent annually. Prospects for red meat, especially hogs, are relatively favourable due to higher prices and lower feed costs. Output of fruit, vegetable and nursery production, and supply-managed products such as dairy and poultry should remain relatively stable, with poultry continuing its steady growth. However, for corn, wheat and, to a lesser extent, soybeans, the impact of lower prices caused by the U.S. Food Security Act of 1985 will be significant. In the tobacco sector, further industry rationalization is expected. Farmers' difficulties in servicing debt will ease somewhat as a result of declining interest rates, government programs and, in many cases, lower levels of debt.

Within the mining sector, gold and platinum are the two brightest spots. The Hemlo area gold mines are still expanding. With the recent rise in gold and platinum prices, and increases in exploration activity, it is possible that a number of new mines will be developed. One zinc deposit is also under

development. However, iron ore mines will continue to face difficulties, reflecting the high operating costs of Ontario mines, and limited demand in downstream steel markets.

Forestry output is expected to improve steadily, reflecting strength in the downstream wood products and pulp and paper industries. In addition, forest management agreements with the major operators are leading to expansion of nurseries and forest regeneration activities.

PRIMARY SECTOR OUTLOOK
(Real Output Growth)



*Annual Average

Source: Conference Board of Canada and Ontario Ministry of Treasury and Economics.

Manufacturing Outlook

Resource-Based Manufacturers

Resource-based manufacturers include pulp and paper, wood products, primary and non-metallic metals, metal fabricating and petroleum refining. The success of most of these industries is closely related to world market conditions. The outlook assumes that moderate growth in the United States and OECD will continue; it also assumes that exports to the important U.S. market will not be significantly curbed or restrained by new protectionist efforts.*

Following very slow growth over the past five years, output is expected to increase significantly between 1986 and 1990. Nonetheless, growth rates will still be below the average for manufacturing or for the economy as a whole.

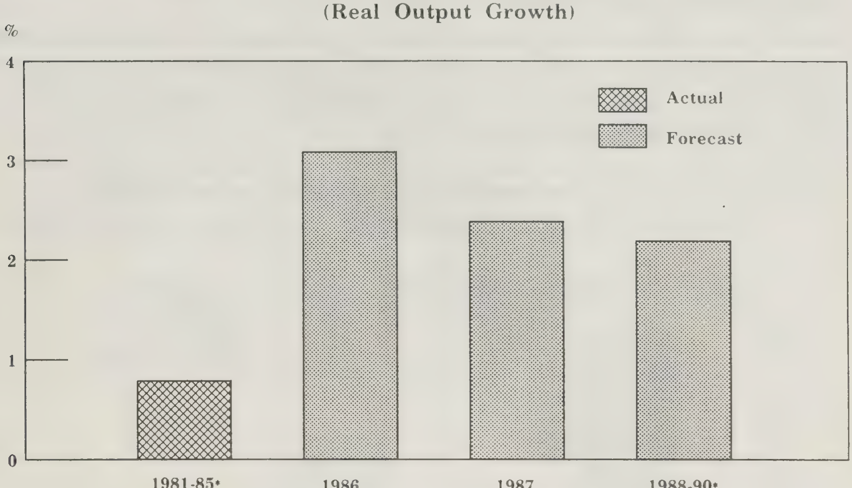
Demand and prices for pulp and paper are increasing again and Scandinavian producers are less competitive in the U.S. market as a result of recent currency adjustments. In addition, the high level of residential

* This forecast is based on a positive resolution of the softwood lumber dispute.

construction activity in Canada and the United States is giving strong impetus to production and exports of lumber. Non-metallic mineral products and fabricated metals, although more oriented to domestic markets, are also benefitting from the pace of construction activity.

While steel producers are completing extensive modernizations, resulting in one of the most efficient industries in the world, very little growth in production is expected during the next five years. Expected increases in demand from the automotive sector are being offset by sharply lower sales to the energy industry, and by restrained exports to the United States. In addition, petroleum refining will experience negligible output growth due to continuing gains in fuel economy in the transportation sector.

RESOURCE-BASED MANUFACTURERS OUTLOOK
(Real Output Growth)



*Annual Average

Source: Conference Board of Canada and Ontario Ministry of Treasury and Economics.

Transportation Equipment

In 1986, real output in Ontario's transportation equipment sector is expected to increase by 4.5 per cent. For 1987, with new production from Honda and AMC coming on stream, real output is anticipated to increase by 5.0 per cent. For the 1988-90 period, continued real growth of 2.9 per cent per year is forecast, buoyed by new investment by both U.S. and Japanese auto companies.

Ontario's transportation equipment sector is dominated by motor vehicles and parts, which account for about 95 per cent of the sector's value of shipments and 85 per cent of its employment. Ontario has benefitted from the automobile industry's drive to become more competitive due to the province's advantageous location and its efficient and cost-effective labour force. North American producers' investments include: Chrysler's mini-van plant in Windsor; AMC's new $764 million assembly plant in Brampton; and GM's $2 billion GM-10 project in Oshawa. In addition, in an attempt to

anchor their export markets, Japanese auto makers are making substantial investments in assembly plants in Ontario: Honda, $200 million; Toyota, $400 million; and Suzuki in partnership with GM, $500 million.

This year, sales of North American cars and trucks are expected to level off, following large increases in 1984 and 1985. However, demand for the larger cars, trucks and mini-vans, in which Ontario's production is concentrated, should continue to expand. Sales of these vehicles will benefit from low gasoline prices and more lenient fuel economy standards in the U.S.

The auto parts sector is expected to grow but at a slower rate than the assembly sector. In part, this is due to increased foreign offshore producer penetration of the U.S. market and a growing trend in the U.S. domestic industry to source parts to newly-industrializing countries such as Brazil, Mexico, Taiwan, and South Korea.

The aerospace industry is growing steadily. In particular, DeHavilland has announced orders and options on 82 new Dash-8 aircraft worth an estimated $730 million. Further orders are anticipated, reflecting the increase in demand for commuter air services.

TRANSPORTATION EQUIPMENT OUTLOOK
(Real Output Growth)

Source: Conference Board of Canada and Ontario Ministry of Treasury and Economics.

Other Manufacturing

Healthy growth is expected in electronics and, to a lesser extent, in electrical products. This will be fuelled by strong business spending, especially in the service sector, and continued strong residential construction and consumer spending on appliances. Machinery sales will be aided by growth in business investment in plant and equipment. Export opportunities in offshore markets will also improve, particularly since

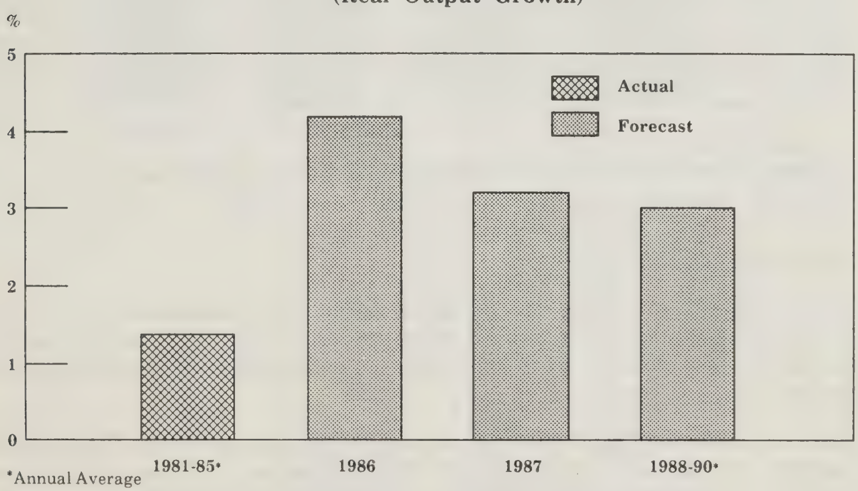
European and Japanese competitors' prices have risen due to currency changes.

Cautious optimism about chemical production is based on lower feedstock prices and industry-wide restructuring, rationalization and productivity improvements in response to world-wide over capacity. Pharmaceuticals, cosmetics, soaps, detergents and specialty chemicals are expected to do well, as are paint manufacturers supplying the construction industry. The plastics industry is expected to gain further market share from more traditional materials such as metals and glass.

The printing and publishing industries will continue to be strong performers. In addition, the furniture and textile industry will be buoyed by the rapid growth in housing construction and renovation. The clothing industry is also demonstrating strength as Canadian design talent becomes better recognized.

The food and beverages industries are expected to show only marginal growth, despite efforts by the industry to introduce new products and adopt newer packaging techniques. The leather products industry is adjusting to the removal of quotas on men's and boys' shoes, and to the relaxation of quotas on women's and girls' shoes. Progressive firms in the industry show prospects of growth in markets for higher priced, high fashion shoes.

OTHER MANUFACTURING INDUSTRIES OUTLOOK
(Real Output Growth)



*Annual Average

Source: Conference Board of Canada and Ontario Ministry of Treasury and Economics.

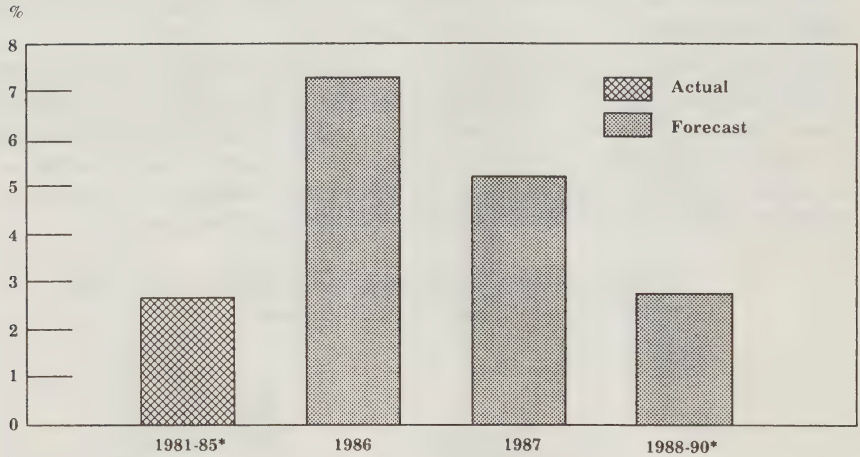
Construction and Utilities Outlook

The construction sector is expected to lead output growth, expanding by 9.5 per cent in 1986 and 6.4 per cent in 1987. In the 1988-90 period, growth is expected to match the overall rate of growth of the economy. This sector is buoyed by the surge in activity in residential construction and by the continued moderate expansion in plant construction. Ontario's housing

starts are expected to climb to 73,000 in 1986, and 77,000 in 1987. Renovations are expected to contribute significantly to the increase in residential construction activity. Non-residential construction is expected to show steady improvement. Most of the strength is attributed to construction projects in the manufacturing sector, primarily the expansion of automobile manufacturing facilities.

The utilities sector includes Ontario Hydro, local electrical utilities, natural gas distributors and water distribution utilities. For 1986 and 1987, output in the utilities sector is forecast to grow in real terms at 4.0 per cent and 3.3 per cent, respectively. In 1988-90 growth will slow to 2.3 per cent annually.

CONSTRUCTION AND UTILITIES OUTLOOK
(Real Output Growth)



*Annual Average

Source: Conference Board of Canada and Ontario Ministry of Treasury and Economics.

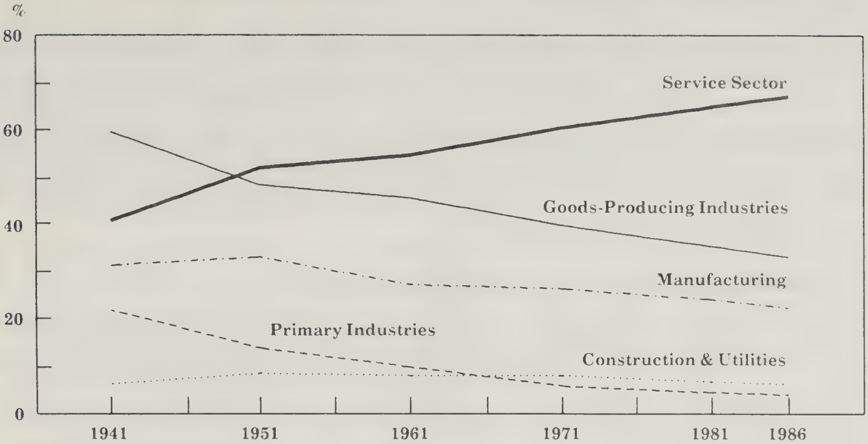
Service Sector Outlook*

The emergence of the service sector as the largest component of Ontario's economy is not a recent or sudden phenomenon. Since 1951, employment in the service sector has exceeded that in the goods-producing industries, and the gap has been increasing rapidly.

Since 1971, the service sector has averaged a real growth rate of 3.5 per cent per year, compared to 3.0 per cent for the economy as a whole. Employment growth in services has been equally impressive. The service sector also shows less cyclical variability in output. Even during the 1982 recession, when other sectors experienced varying degrees of setback, services managed 0.2 per cent growth in output.

* For a more detailed analysis of this sector, see Background Notes on the Service Sector in Ontario, Ministry of Treasury and Economics, May 1986. A final report by Mr. George Radwanski is forthcoming.

SHARE OF ONTARIO EMPLOYMENT BY SECTOR

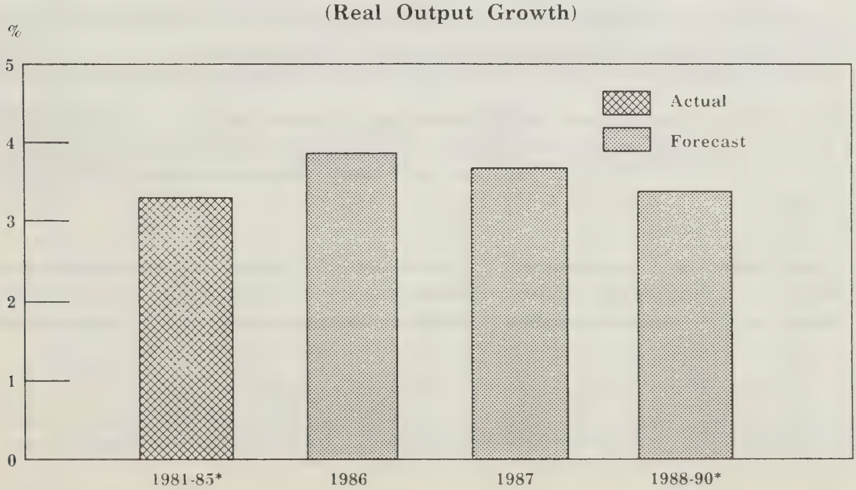


Source: Statistics Canada.

Several factors are contributing to the expansion of the service sector. The information age and the growing complexity of the economy are increasing the need for financial, legal, accounting, advertising, computer and other specialized services. The strongest growth is in these areas. The aging of Ontario's population is increasing demand for services related to health and personal care. Increased personal incomes and the growth of two-earner families are leading to greater demand for recreational, educational and household services. In particular, tourism will be an important beneficiary of the steady growth in household incomes. Increased promotional efforts and the favourable exchange rate will also enhance Ontario's attractiveness to both domestic and foreign tourists. An estimated $8.2 billion will be spent in 1986 by all travellers in Ontario.

Real output in the service sector is expected to grow somewhat more rapidly than in the goods-producing sector throughout the forecast period. Services will continue to be Ontario's major source of employment growth.

SERVICE SECTOR OUTLOOK
(Real Output Growth)



*Annual Average

Alternative Scenarios

All forecasts depend on assumptions. Because Ontario's is a relatively small open economy, highly vulnerable to developments in the rest of the world, the key assumptions for Ontario concern external factors. The base case, outlined earlier, presumes a generally supportive international economic environment and a reduction in real interest rates. This section develops two alternative scenarios based on different assumptions about the performance of the U.S. economy.

Alternative Scenario I: Lower U.S. Growth

In this lower growth scenario, the U.S. trade deficit worsens as a result of falling demand for U.S. industrial exports and increased penetration of the U.S. market by imports, notably from newly-industrializing countries. As a result, real U.S. growth declines to 0.3 per cent in 1987 (compared to 2.9 per cent in the base case).

Lower growth would also lead to a larger than expected federal budget deficit. Current concern over the size of the U.S. budget deficit suggests it would be unlikely for fiscal stimulus to be used to offset the effects of a slowdown. In addition, a worsening federal budget deficit may limit the Federal Reserve Board's ability to reduce interest rates further, particularly if central banks in Germany and Japan refuse to parallel cuts in the Board's discount rate. Monetary policy could be restrained by the need to attract sufficient overseas capital to help finance both the current account deficit and the federal budget deficit.

- The impact of the trade deficit on growth would be compounded by further declines in business investment.
- Consumer spending, currently the major source of growth in the U.S. economy, would be reduced as a result of slower employment and income growth.

Table 9 summarizes the short-term impact of slower U.S. growth on Ontario's economic performance.

The 1987 Ontario Economy: Alternative Scenario I — **Table 9**

	Real Growth (%)	Inflation (%)	Job Creation (000s)	Unemployment Rate (%)
Base Case	3.6	3.5	114	6.7
Low Growth	1.5	3.3	65	7.8

Source: Ontario Ministry of Treasury and Economics.

- Initially, the impact of a stagnating U.S. economy would be felt in Ontario's export sectors such as autos, resource-based commodities, and certain capital goods oriented to U.S. markets. However, lower employment and income growth in the export sectors would ultimately weaken domestic demand.
- The slowdown in global demand would limit growth of markets for Ontario products and undermine business confidence, resulting in reduced business investment in Ontario.
- Profits would decline in 1987; sales volumes and margins would be hard-hit. Projects currently underway would likely be completed as firms attempted to assess the severity of the decline in demand. Projects now in the planning stage would be unlikely to come to fruition until growth has resumed and excess capacity has been absorbed.
- The housing sector would remain fairly buoyant over the short-term as pent-up demand and lower interest rates would continue to spur growth. However, weaker growth in personal income eventually would have a dampening effect on the demand for housing.

In this scenario it is assumed that the United States does not adopt new protectionist measures. However, the impact would be exacerbated by aggressive U.S. protectionism in reaction to a further deterioration in the U.S. trade deficit.

Over the medium-term horizon, while the U.S. economy would be expected to rebound toward the latter half of 1988, growth would be lower than assumed in the base case. The U.S. economy would average 2.5 per cent growth during the 1988-1990 period, as opposed to 3.0 per cent in the base case.

Slower growth in the U.S. would, in turn, induce slower growth in the Ontario economy over the medium term. Real growth in Ontario would average 2.2 per cent annually between 1988-1990, down from 3.1 per cent in the base case.

- Slower U.S. growth would directly reduce export growth which in turn will have an adverse multiplier effect on consumption.
- Business investment would also be adversely affected as a result of both weaker domestic demand and exports.

The 1988-1990 Ontario Economy: Alternative Scenario I **Table 10**

	Average Real Growth (%)	Average Inflation Rate (%)	Average Job Creation (000s)	1990 Unemployment Rate (%)
Base Case	3.1	3.9	103	5.5
Low Growth	2.2	3.8	87	6.6

Source: Ontario Ministry of Treasury and Economics.

Alternative Scenario II: Higher U.S. Growth

In this scenario, improved international co-ordination of economic policy, with the objective of generating more rapid and better balanced growth, is assumed to lead to a stronger world economy. The U.S. trade deficit declines significantly, as Japan and Western Europe adopt more stimulative economic policies. Growth in the U.S. would rise to 3.7 per cent in 1987 from 2.9 per cent in the base case.

- Faster growth would help bring down the U.S. budgetary deficit, reducing the pressure for fiscal restraint.
- A stronger U.S. economy would buy more of the goods and services produced in the rest of the world, including Ontario.

Table 11 shows the short-term effects on the Ontario economy of more rapid American growth.

The Ontario Economy in 1987: Alternative Scenario II — **Table 11**

	Real Growth (%)	Inflation (%)	Job Creation (000s)	Unemployment Rate (%)
Base Case	3.6	3.5	114	6.7
High Growth	4.5	4.0	127	6.6

Source: Ontario Ministry of Treasury and Economics.

- Faster growth in Ontario would bring the unemployment rate down more rapidly.
- Consumer spending would be stimulated by falling unemployment, stronger income growth and the boost to consumer confidence resulting from a healthier world economy.
- Ontario industries benefitting most directly and immediately from a stronger U.S. and world economy would include transportation equipment, mining and metals, forest products, machinery and electrical products. To a lesser extent, industries oriented to consumer goods and services would also benefit.

Over the medium term, 1988-1990, the U.S. economy would be expected to grow at an average annual rate of 3.8 per cent. Stronger U.S. growth would facilitate a more rapid decline in the U.S. federal deficit, in turn permitting the Federal Reserve Board to loosen monetary policy. This would result in lower interest rates than assumed in the base case.

As in the short-run, Ontario would reap significant benefits. Real annual growth in Ontario would average 3.6 per cent, 0.5 percentage points higher than in the base case.

- Initially, exports would be stimulated the most. Subsequently, consumption would be stimulated by stronger income growth and

investment would be enhanced by increased domestic and foreign demand.

- Canadian interest rates would fall in line with U.S. rates and provide further stimulus to both the consumer and business sectors.
- The unemployment rate would drop to 5.2 per cent by 1990, as compared to 5.5 per cent in the base case. The additional decline in the unemployment rate due to higher growth would be moderated to some extent by more rapid labour force growth.
- Inflation would be somewhat higher, averaging 4.5 per cent between 1988-1990, 0.6 percentage points higher than in the base case. This reflects the impact of the stronger domestic and international economic environment on commodity prices and wages.

The 1988-1990 Ontario Economy: Alternative Scenario II — **Table 12**

	Average Real Growth (%)	Average Inflation (%)	Average Job Creation (000s)	1990 Unemployment Rate (%)
Base Case	3.1	3.9	103	5.5
High Growth	3.6	4.5	111	5.2

Source: Ontario Ministry of Treasury and Economics.

The following table consolidates the scenarios for the Ontario economic outlook for both the short and medium term.

Summary of Scenarios — **Table 13**

	Real Growth (%)	Inflation (%)	Job Creation (000s)	Unemployment Rate (%)
1985 Actual	4.7	4.0	159	8.0
1986 Forecast	4.1	4.0	156	7.0
1987				
Base Case	3.6	3.5	114	6.7
Alternative Scenario I	1.5	3.3	65	7.8
Alternative Scenario II	4.5	4.0	127	6.6
1988-90*				
Base Case	3.1	3.9	103	5.5
Alternative Scenario I	2.2	3.8	87	6.6
Alternative Scenario II	3.6	4.5	111	5.2

Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

* Annual averages, except for the unemployment rate which is for 1990.

Ontario Fiscal Review

Revenue Structure*

This section provides a brief overview of Ontario's revenue structure and describes some of its key characteristics.

Composition of Provincial Revenues

The Province has a broad range of revenue sources including taxation, transfer payments from the federal government, other budgetary revenue and non-budgetary sources.

The three major taxation sources – personal income tax, corporation taxes, and retail sales tax – contribute 55 per cent of estimated total 1986-87 revenues. Taxation of gasoline and diesel fuels contribute a further 4.0 per cent. In total, approximately 63 per cent of 1986-87 revenue will be raised through taxation.

Transfer payments from the federal government account for 16 per cent of 1986-87 revenue. Within federal transfer payments, Established Programs Financing and Canada Assistance Plan payments account for 59 per cent and 22 per cent respectively.

Other budgetary revenue sources include OHIP premiums, fees and licences, LCBO profits, interest on investments and lottery profit revenue. These sources contribute 16 per cent of this year's revenue.

Non-budgetary revenues, including net deposits in trust accounts and net repayments of loans and investments, account for the remaining 5.0 per cent of total revenue.

The Major Taxation Sources

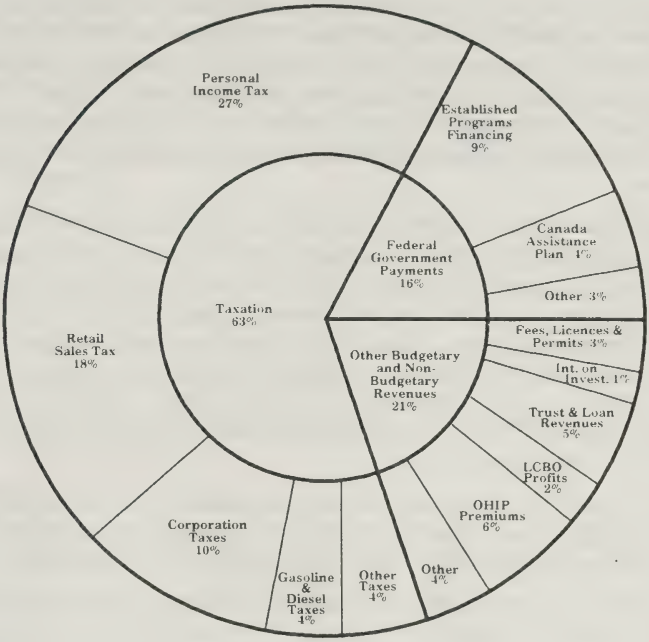
Personal Income Tax

Under the terms of a Tax Collection Agreement between the two governments, the federal government collects and administers the Ontario Personal Income Tax (PIT) on behalf of the Province. The federal government determines the tax base. Basic Federal Tax is calculated by applying a marginal rate structure to this base. Total federal tax is then determined by applying federal surtaxes and credits. Ontario PIT is defined as a proportion of Basic Federal Tax. For 1986, the Ontario rate is 50 per cent. In addition, a surtax of 3.0 per cent is applied to Ontario tax in excess of $5,000. Ontario income tax accounts for roughly one-third of an individual's total income tax.

With limited exceptions, such as social assistance payments and lottery winnings, all sources of income are subject to tax. Deductions and exemptions are provided for certain personal and income earning expenses.

* All Ontario revenue figures for 1986-87 are based on the September 30, 1986, Ontario Finances.

COMPOSITION OF ONTARIO'S REVENUES
1986-87*



***Forecast**
Source: Ontario Ministry of Treasury and Economics.

Provisions in the PIT system also support investment and saving for retirement.

The federal marginal tax rates for 1986, including the impact of federal surtaxes, range from 6.1 per cent in the lowest bracket to 37.9 per cent on income in the highest tax bracket. Ontario marginal rates, before consideration of surtaxes, are one-half of the basic federal rates. Actual Ontario rates after incorporating the Ontario surtax rise to a maximum of 17.5 per cent for 1986. Combining the two rate structures yields a 1986 maximum total marginal rate of 55.4 per cent.

Ontario has implemented special programs to relieve tax burdens on low-income Ontarians. The Ontario Tax Reduction removes from the 1986 tax roll 350,000 individuals with taxable income of $1,630 or less. Another 40,000 individuals with taxable income between $1,630 and $1,760 pay reduced Ontario tax. There is no comparable federal tax reduction for low-income taxpayers. In addition, Ontario provides refundable Property and Sales Tax Credits that will return $275 million to Ontario taxpayers in 1986-87. The Property Tax Credit, claimed by the spouse with the higher taxable income, is equal to $180 plus 10 per cent of property tax or 2.0 per cent of rent. The Sales Tax Credit is calculated as 1.0 per cent of personal exemptions. These credits are collectively reduced by 2.0 per cent of taxable income. Over 90 per cent of these tax credit benefits are received by individuals earning less than $20,000.

Corporate Taxes

The Province of Ontario levies three general taxes on the corporate sector: Corporations Income Tax, Capital Tax and Insurance Premiums Tax. All corporations in Ontario, with the exception of insurance companies, are required to pay Capital Tax based on their paid-up capital. Insurance companies pay Insurance Premiums Tax based on the amount of premiums received in respect of Ontario policies. Mining companies are subject to the Mining Tax.

The largest amount of corporate revenue is generated through the Corporations Income Tax (CIT). Ontario determines the CIT base and rate structure for the Province. Although significant differences have existed from time to time, Ontario's current base essentially parallels the federal corporate income tax base. Tax is imposed on gross corporate revenues earned in the taxation year less allowable expenses. Various corporate activities receive special treatment through lower rates or accelerated deductions. Capital Taxes and Insurance Premiums Taxes are deductible expenses for income tax purposes.

The 1986 general Corporations Income Tax rate is 15.5 per cent of taxable income. Income from manufacturing and processing operations, mining, logging, farming and fishing is taxed at the rate of 14.5 per cent.

Eligible small businesses are exempt from income tax in the first three years of their operation and pay tax at a 10 per cent rate thereafter.

Ontario, as well as Alberta and Quebec, administers its own Corporations Income Tax. All other provinces have entered into tax collection agreements with the federal government.

Retail Sales Tax

The Retail Sales Tax (RST) is payable on the sale of most goods and on certain services. The tax is calculated as a specific percentage of the final sale price to the consumer (including any federal levies). Since 1973, the general RST rate applying to most taxable items has been set at 7.0 per cent. Three other rates apply to specific items and services: 5.0 per cent on transient accommodation; 10.0 per cent on admission fees over $4 and beverage alcohol products sold at licensed establishments; and 12 per cent on beverage alcohol products sold at retail outlets.

A number of items are specifically exempt from RST. The most notable include groceries, energy used for heating and lighting, children's clothing, prescription drugs, specific reading material and production machinery and equipment. Most services are excluded from the RST tax base.

Ontario's RST base and rates are determined by the Province. Registered vendors collect the tax as agents of the Province and remit it to the government.

Motive Fuel Taxes

Ontario levies tax on motive fuels under the authority of two Acts - the Gasoline Tax Act and the Fuel Tax Act. Under both Acts, the tax base is applied to conventional petroleum-based products. Non-conventional fuels

such as natural gas, propane, alcohol (used alone or blended with another fuel) and other manufactured gases are exempt.

Fuel taxes are levied on a per litre basis. The Provincial tax is 8.3 cents per litre on gasoline purchased in Ontario. This tax applies to licensed motor vehicles, snowmobiles and pleasure marine craft. Farming, commercial fishing, industrial, commercial, institutional, heating and cooking uses qualify for an exemption or a full rebate of taxes paid, provided that the fuel is consumed off-road.

A 1.88 cent per litre tax applies to all aviation fuels purchased in Ontario.

Diesel fuel purchased in Ontario for use in licensed on-road motor vehicles is subject to tax of 9.9 cents per litre. As with the gasoline tax, certain off-road uses qualify for a full rebate of tax paid or are exempt at the time of purchase. A system of fuel colouration is in place to distinguish diesel fuels sold for exempt purposes, such as farming.

Tax of 3.1 cents per litre is applied to diesel fuel purchased in Ontario to power railroad locomotives.

Per Point Yields

Table 1 illustrates the 1986-87 revenue yield of selected revenue sources on a per point basis. The yields reflect a full year's revenue and in each case the tax points relate to a specific base.

Per Point Yield, 1986-87 **Table 1**

($ Million)

Retail Sales Tax		
7% - General	712	
5% - Transient Accommodation	7	
12% - Alcohol (Retail Outlets)	27	
10% - Alcohol (Licensed Premises) and Admission Fees	16	
Personal Income Tax	171	
Corporate Income Tax		
15.5% - General	71	
14.5% - Manufacturing and Processing, Fishing, Logging and Farming	65	
10% - Small Business	37	
Capital Tax	136	Per 1/10 point
Tobacco Tax	11	1¢ per pack of 20
Motive Fuel Taxes		
Gasoline & Aviation Fuel	133	1¢ per litre
Road and Rail Diesel	33	1¢ per litre
OHIP Premiums (Individual and Family)	56	Per $1/$2
Land Transfer Tax	36	Per 1/10 point

Note: See text for interpretation of these data.

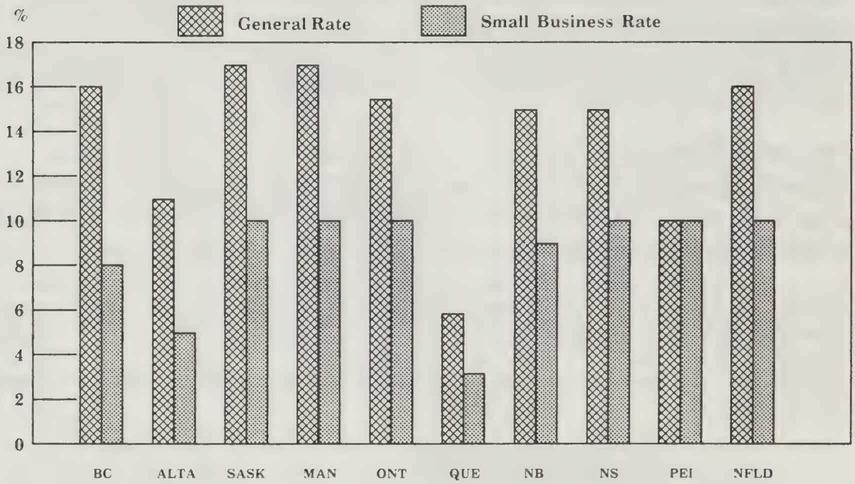
Source: Ontario Ministry of Treasury and Economics.

For example, one percentage point on the general RST rate yields approximately $712 million. The per point yield of the PIT is illustrated as an incremental percentage of Basic Federal Tax, and each percentage yields $171 million.

Interprovincial Comparison

As illustrated in the following chart, Ontario's general and small business corporate income tax rates are comparable with those in most Canadian provinces but are above rates in Alberta and Quebec.

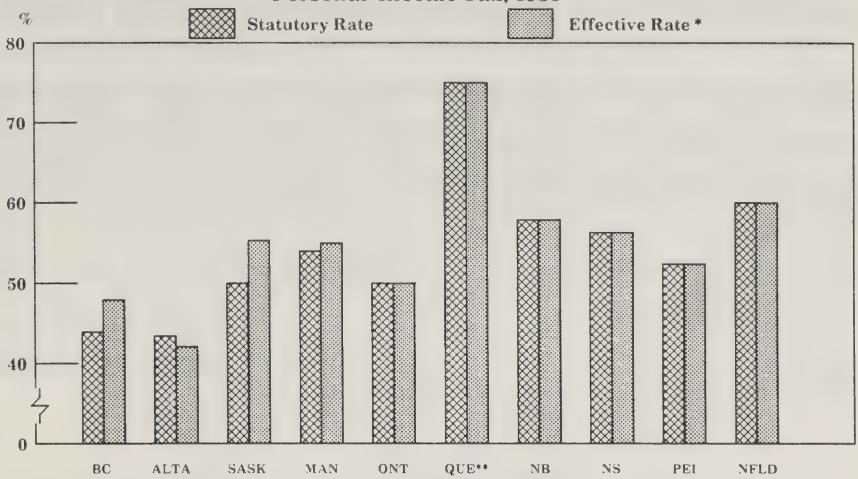
INTERPROVINCIAL TAX COMPARISON:
Corporation Income Tax, 1986



Source: Ontario Ministry of Treasury and Economics and provincial tax statutes.

Provincial personal income tax rates and provincial personal income tax revenues as a percentage of Basic Federal Tax are illustrated below. Ontario's effective rate is 50.1 per cent, including the 1986 surtax.

INTERPROVINCIAL TAX COMPARISON:
Personal Income Tax, 1986



Notes: * Effective rate is total provincial income tax revenue, including any surtaxes and net of any tax reductions, as a percentage of Basic Federal Tax assessed in the province.

** Estimated rate; Quebec does not impose tax as a percentage of Basic Federal Tax.

Source: Ontario Ministry of Treasury and Economics and provincial tax statutes.

The general retail sales tax rates in Canada range from zero per cent in Alberta to 12 per cent in Newfoundland. Ontario's rate is approximately in the middle of the range at 7.0 per cent.

INTERPROVINCIAL TAX COMPARISON:
Retail Sales Tax, 1986

Note: * No provincial sales tax is imposed.

Source: Ontario Ministry of Treasury and Economics and provincial tax statutes.

Straight rate comparisons must, however, be used with caution. Differences in the taxable base are particularly important in interprovincial

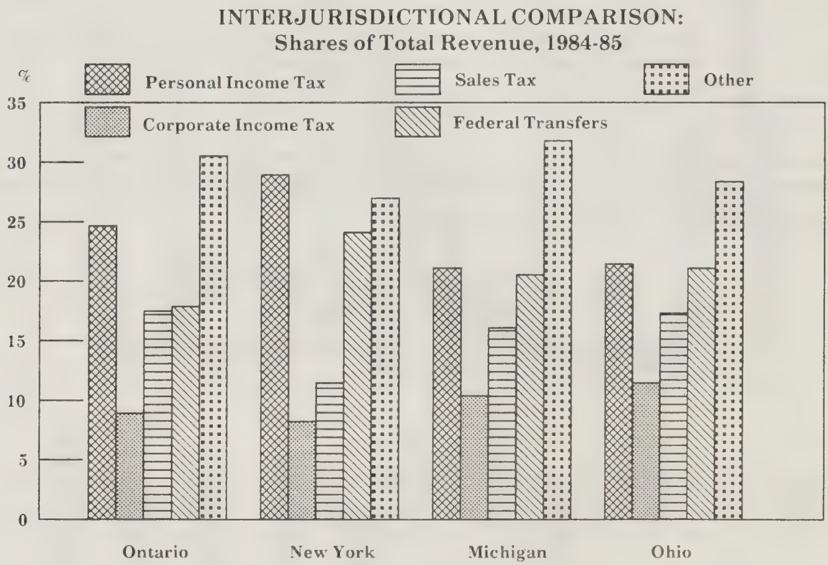
comparisons of RST. Significant interprovincial differences in RST exemptions also exist in areas such as advertising, insurance premiums, transient accommodation and personal services.

Relative tax rates in these major tax areas also reflect the approach taken in each province to support health care expenditures. Ontario, Alberta and British Columbia raise additional revenue through Health Insurance Premiums ranging from $168 annually for a single individual in Alberta to $357 for an individual in Ontario. Quebec and Manitoba levy payroll taxes.

Ontario and Neighbouring U.S. Jurisdictions

The Revenue Structures

The following chart illustrates the composition of 1984-85 revenues in Ontario and the states of New York, Michigan and Ohio.



Source: Ontario Ministry of Treasury and Economics and the financial statements of U.S. States.

All four jurisdictions rely heavily on the revenues generated by corporation taxes, personal income taxes and sales taxes as these three sources account for about half of total revenues.

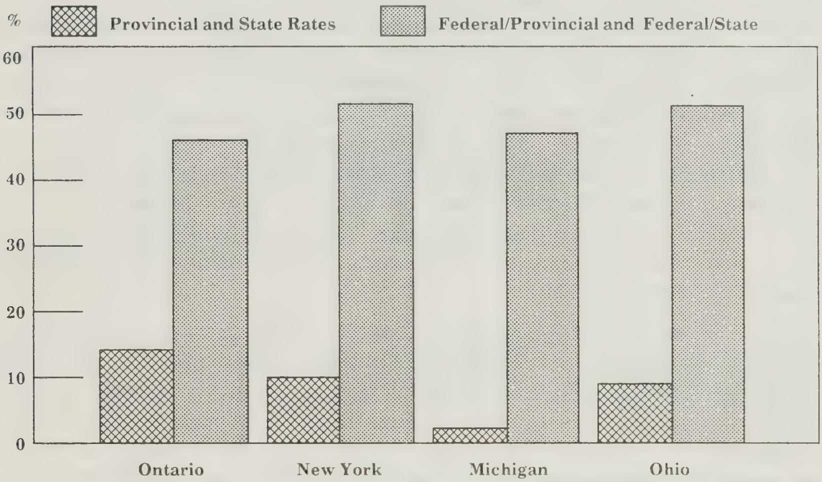
Federal transfer payments represent a major contribution to total revenues in all four jurisdictions. For Ontario, federal transfers represent a lower proportion of total revenues than is the case in the U.S. jurisdictions. In 1984-85 for example, transfers from Ottawa accounted for 18 per cent of total Ontario revenues, while all three U.S. jurisdictions received over 20 per cent of their revenues from federal transfer payments.

Differences in U.S. states' and Ontario's reliance on various revenue sources is further illustrated in a comparison of the jurisdictions' major tax rates.

Corporate Income Taxation

The combined federal-provincial and federal-state corporate tax rates on manufacturers in Ontario and in selected U.S. states are illustrated in the chart below. The federal tax rates in Canada and the U.S. are 41.5 per cent and 46 per cent respectively. The Canadian federal tax rate includes the impact of the 1986 corporate surtax which is 5.0 per cent of federal tax payable. The combined federal-state tax rates reflect the deductibility of state corporate taxes for the purposes of calculating federal taxes. In Canada, provincial taxes are not deductible. In lieu of deductibility, corporations are allowed a 10 per cent provincial tax abatement against the federal statutory rate.

INTERJURISDICTIONAL TAX COMPARISON:
Corporate Income Tax on Manufacturers, 1986



Source: Ontario Ministry of Treasury and Economics, Canadian and United States federal tax statutes and Ontario and state tax statutes.

There are also differences between the U.S. and Canada in calculating the tax base for purposes of corporate income tax. For example, the method of calculating depreciation for tax purposes differs considerably.

Sales Taxation

General sales tax rates in each of the four jurisdictions are compared in Table 2. In contrast to the sales tax systems in Canada, some American municipalities have the authority to impose sales taxes and special levies related to municipal undertakings such as rapid transit. As with the interprovincial analysis, however, these rate comparisons must be used with caution as there are differences in tax bases.

Interjurisdictional Sales Tax Rate Comparison, 1986 **Table 2**
(Per Cent)

Jurisdiction	Rate	Maximum Local Rate	Maximum Combined Rate
Ontario	7	N/A	7
New York	4	4.25	8.25
Michigan	4	N/A	4
Ohio	5	2.5	7.5

Source: Ontario Ministry of Treasury and Economics, Canadian and United States federal tax statutes and Ontario and state tax statutes.

Personal Income Taxation

A meaningful comparison of the Ontario and U.S. personal income tax systems is difficult. While both tax systems generally have the same objective (taxing income) and employ similar approaches (marginal tax rates) in achieving this objective, the two systems are fundamentally different. First, there are significant differences in the taxable income bases. Many of the tax preferences available to Americans in 1986 are not available in Ontario. (On a lesser scale, the reverse is also true.) Furthermore, all provinces in Canada except Quebec levy provincial income tax as a per cent of federal tax. In the U.S., each state controls its own personal income tax system and can vary it considerably from the U.S federal system. Some states tax income directly while others calculate tax based on federal tax.

Despite these limitations, a quantitative comparison of representative tax filing scenarios can be performed. Ontario's latest study of this nature is based on 1983 tax systems. In broad terms, the study showed that Ontario taxpayers at the lowest income levels faced lower tax burdens than their counterparts in the neighbouring states of New York, Ohio and Michigan. In the middle income range, tax burdens were similar in all jurisdictions. At upper income levels, Ontario taxpayers paid considerably more income related taxes.

Tax Reform

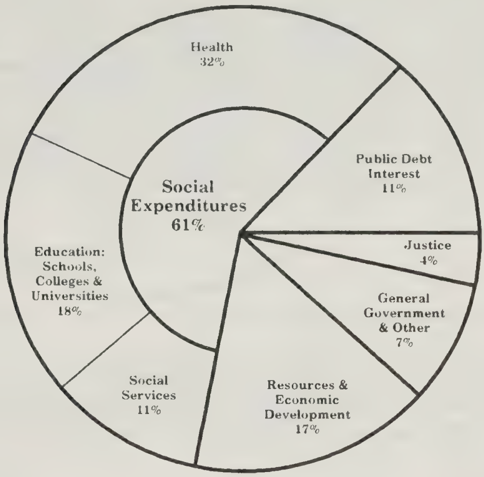
A comprehensive overhaul of the U. S. federal tax system is expected to be in place by January 1987. The tax reform package lowers personal and corporate income tax rates, broadens the tax bases and results in a shift in tax burden from individuals to corporations. These changes will alter the relative tax burdens between Ontario and the U.S. states as discussed above.

The federal government in Canada has recently indicated its commitment to comprehensive tax reform in this country. While it is far from clear what the final package will be, the potential exists for significant changes in the tax burdens of Canadian individuals and businesses.

Expenditure Structure*

Provincial expenditures support a wide range of programs, services and capital projects. This spending will amount to approximately $31.8 billion in 1986-87. Key components of Ontario's expenditures are shown in the following graph.

DISTRIBUTION OF ONTARIO'S EXPENDITURES 1986-87 *



*** Forecast**
Source: Ontario Ministry of Treasury and Economics.

Expenditures on social programs will account for 61 per cent of Provincial spending. These social expenditures include funding to support Ontario's health care and education systems, as well as social assistance programs and services.

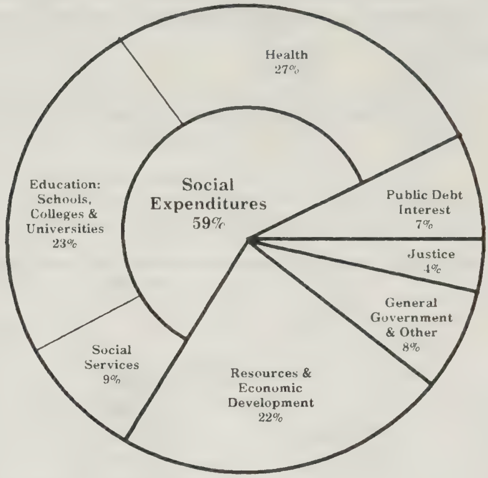
Provincial spending in support of resources and economic development will represent 17 per cent of Ontario's expenditures. This portion includes funding for the maintenance and construction of the transportation system, forest management programs, industrial and agricultural assistance programs, environmental protection and skills training.

Expenditures to support the administration of justice, the operation of Government and the Legislature will together account for 11 per cent. Interest payments on the public debt will represent another 11 per cent of Provincial spending this year.

The distribution of Ontario's expenditures has changed since 1976-77. The key components are shown in the following graph.

* All Ontario Expenditure figures for 1986-87 are based on the September 30, 1986, Ontario Finances.

DISTRIBUTION OF ONTARIO'S EXPENDITURES
1976-77



Source: Ontario Ministry of Treasury and Economics.

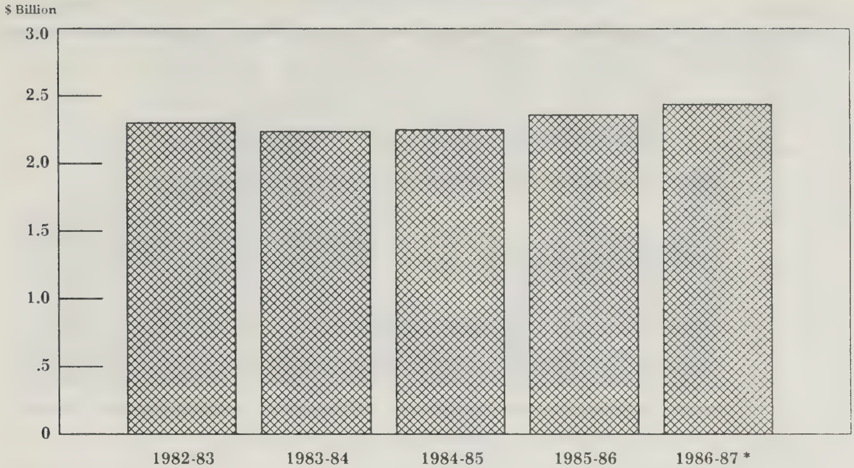
Expenditure on the Health, Social Services, Public Debt Interest components have increased as a proportion of the total spending while that of Education, Resources and Economic Development has declined since 1976-77.

Capital Expenditures

The Provincial Government directly, or indirectly through transfer payments, will provide $2.4 billion for capital investments in 1986-87. Capital expenditures support the construction of roads, water and sewage facilities, hospitals, day nurseries and educational facilities. Also included is the purchase of transit equipment and joint capital projects with private industry.

During the five-year period from 1982-83 to 1986-87 capital spending ranged between $2.2 billion and $2.4 billion.

CAPITAL EXPENDITURES



* Forecast
Source: Ontario Ministry of Treasury and Economics .

Fiscal Performance

Ontario's fiscal performance will be measured in terms of a number of the commonly used indicators. A 10 year review of Selected Financial and Economic Statistics can be found in the Appendix.

Net Cash Requirements

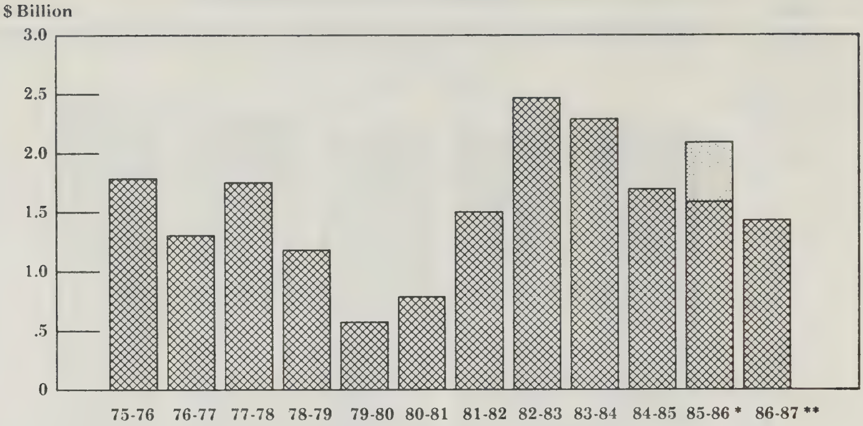
Net cash requirements (NCR) represent the shortfall between total revenues and total expenditures. Ontario's net cash requirement levels are a reflection of overall economic performance, stabilization policies and total spending.

Beginning in 1975, Ontario's NCR experienced a downward trend which resulted in a low of $0.6 billion in 1979-80. In the early 1980s, a deterioration of world economic conditions had an adverse impact on Provincial finances, eventually leading to a NCR of almost $2.5 billion in 1982-83. In that fiscal year, NCR as a proportion of total Provincial spending rose to 10.8 per cent, up from the 1979-80 proportion of 3.7 per cent.

Net cash requirements in 1986-87, at slightly more than $1.4 billion, are projected to be $1.0 billion less than the 1982-83 peak. As well, net cash requirements are expected to decline to 4.5 per cent of total spending.

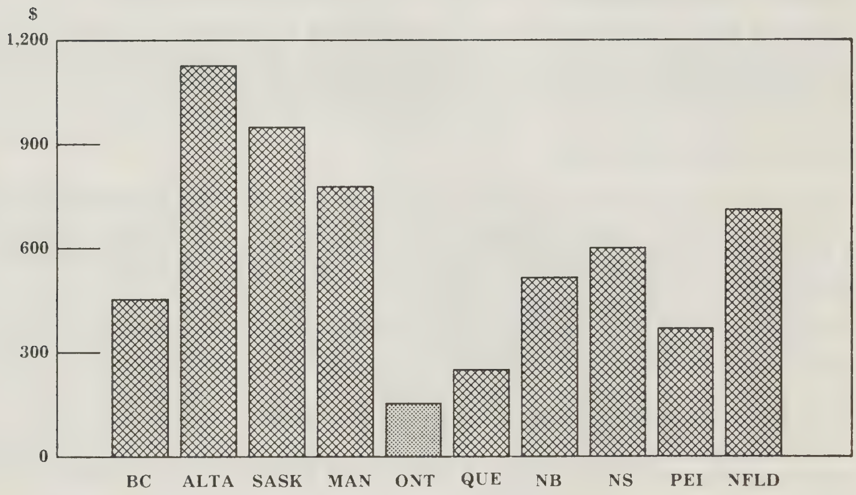
Ontario's net cash requirements per capita, at $157, are estimated to be the lowest among the provinces in 1986-87. It should be noted that this comparison has certain limitations in that financing for Crown corporations, public service pension funds and health insurance programs are treated differently by several provinces.

ONTARIO'S NET CASH REQUIREMENTS (NCR)



*Note: The shaded area represents NCR after extraordinary adjustments.
** Forecast
Source: Ontario Ministry of Treasury and Economics.

NET CASH REQUIREMENTS PER CAPITA
1986-87 *



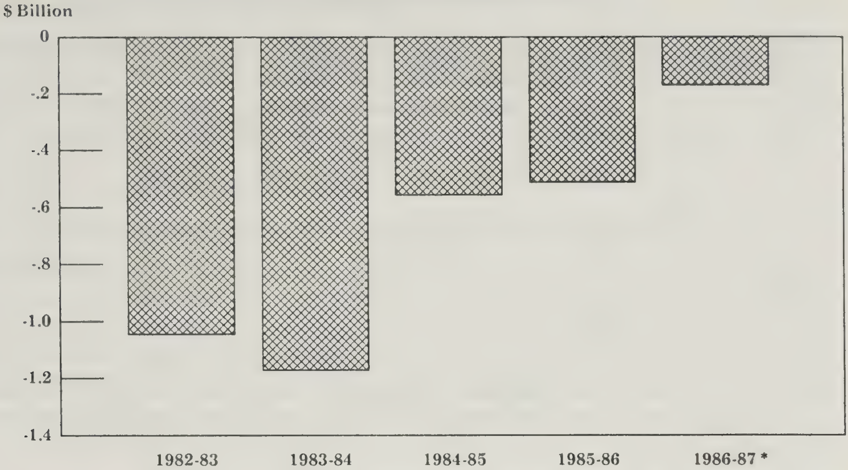
* Forecast
Source: Ontario Ministry of Treasury and Economics.

Operating Position

The operating position is the difference between total current revenues and total current expenditures excluding capital expenditures. The operating position reflects the degree to which the Province pays for its day-to-day operating needs from its current revenues.

Ontario's operating position will improve from a $1.0 billion operating deficit in 1982-83 to $0.2 billion in 1986-87.

OPERATING POSITION



* Forecast
Source: Ontario Ministry of Treasury and Economics .

Total Debt as a Per Cent of Gross Provincial Product

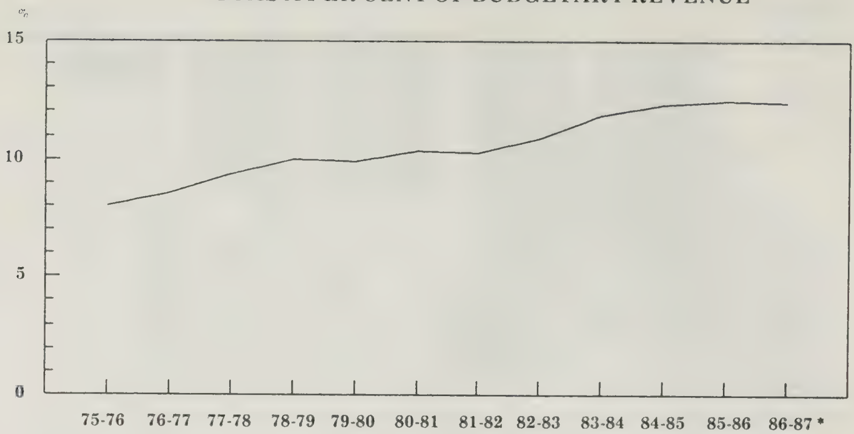
Ontario's total debt comprises funded and unfunded debt. Funded debt has a specified term to maturity and is secured by a debt instrument such as a bond or Treasury Bill. Unfunded debt is not secured by debt instruments.

The capacity of a government to carry its debt is largely determined by the underlying strength of the economy and tax revenues. The ratio of total debt to GPP rose to 18.4 per cent in 1978-79 and then fell to 16.8 per cent in 1981-82. It increased to 18.4 per cent in 1985-86 and is forecast to fall to 18.3 per cent in 1986-87.

Public Debt Interest

Public debt interest (PDI) costs for servicing total debt have absorbed an increased share of Provincial revenues. PDI costs have grown from 8.0 per cent of budgetary revenues in 1975-76 to an estimated 12.4 per cent in 1986-87.

PDI AS A PER CENT OF BUDGETARY REVENUE

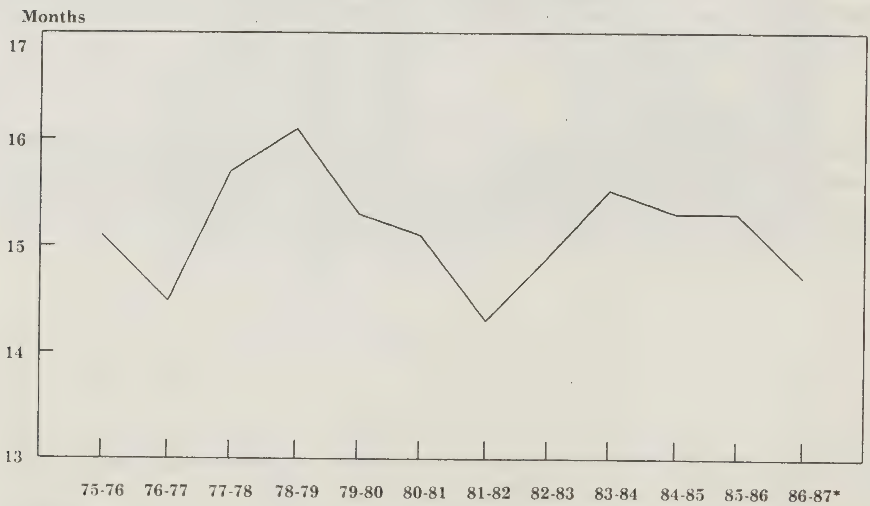


* Forecast
Source: Ontario Ministry of Treasury and Economics.

Months of Budgetary Revenue Required to Repay Total Debt

Since 1975-76, the number of months of budgetary revenue required to repay total debt has ranged from a high of 16.1 months in 1978-79 to a low of 14.3 months in 1981-82. It would take 14.7 months of budgetary revenue to repay total debt in 1986-87.

MONTHS OF BUDGETARY REVENUE
TO REPAY TOTAL DEBT



* Forecast
Source: Ontario Ministry of Treasury and Economics.

Fiscal Capacity and Tax Effort

Fiscal capacity measures the relative ability of a province to raise revenues from available revenue sources. Tax effort measures the relative extent that each province taxes those available revenue sources. In this section, these measures are used to make interprovincial comparisons.

Determination of Fiscal Capacity

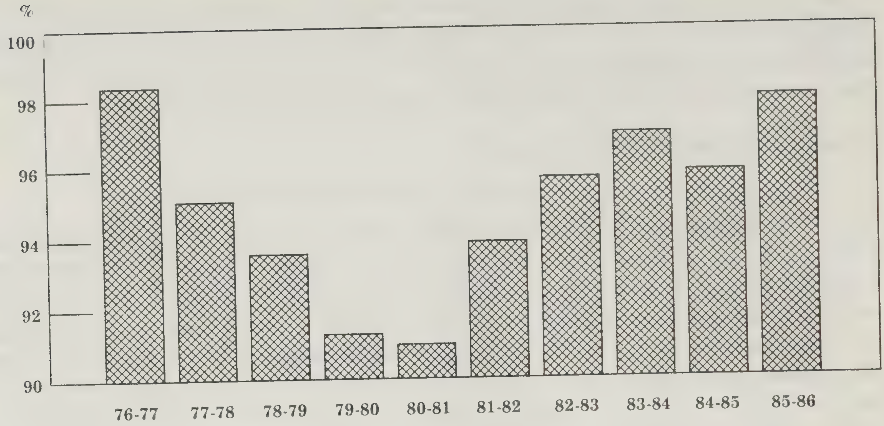
Fiscal capacity can be measured by a number of different indices.

The Representative Tax System (RTS) is the one used by the federal and provincial governments as a measurement of fiscal capacity. In the RTS, each revenue source has an associated tax base and the fiscal capacity can be related to population. For example, the base for tobacco taxes is the number of cigarettes sold in a province. If a province's share of a base is lower than its population share, that province is said to have a fiscal capacity deficiency in that tax base. If the opposite is true, a fiscal capacity surplus exists. In other words, a province has a fiscal capacity deficiency in a tax base if its per capita share of a base is less than the national average.

Tax bases are defined according to the taxing practices of provinces. For example, if an item such as infants' clothing is exempt from the retail sales tax in a majority of the provinces, such sales would not be included in the tax base. Hence, the term "representative".

Employing data from the federal equalization program, it is possible to derive an aggregate tax base share by "adding" together 39 different provincial and local tax bases. This provides a single but comprehensive measure of a province's relative fiscal capacity. In 1985-86, Ontario's fiscal capacity, measured on this basis for provincial own-source revenues, was 98 per cent of the national average. The chart below indicates how Ontario's fiscal capacity has varied over the past ten years. The range of fiscal capacities in 1985-86 was 59.7 per cent for Newfoundland to 199.6 per cent for Alberta. The fiscal capacities of Saskatchewan and British Columbia also exceeded the national average. The natural resource tax base continues to account for their high rankings.

FISCAL CAPACITY OF ONTARIO
(Per Cent of National Average)



Source: Department of Finance and Ontario Ministry of Treasury and Economics.

As Table 3 shows, if federal transfer revenues are added to provincial own-source revenue, the fiscal capacity of "have-not" provinces approaches the national average. Since federal transfers are relatively greater for the "have-not" provinces, the relative fiscal capacities of the "have" provinces decline. For example, Ontario's 1985-86 fiscal capacity declines almost 7.0 percentage points to 91.1 per cent of the national average, primarily because the Province does not receive federal equalization payments.

Table 3

Indices of Provincial-Local Fiscal Capacity, 1985-86

(Per Cent of National Average)

	Provincial-Local Own-Source Revenue	Provincial-Local Own-Source Revenues plus All Federal Transfers
Newfoundland	59.7	91.4
Prince Edward Island	60.8	93.1
Nova Scotia	72.0	89.4
New Brunswick	67.1	92.2
Quebec	79.3	91.5
Ontario	**98.0**	**91.1**
Manitoba	81.3	90.1
Saskatchewan	104.7	99.8
Alberta	199.6	172.8
British Columbia	104.3	99.1
National Average	100.0	100.0

Source: Department of Finance.

Included in the determination of federal transfers are special contracting-out tax points that Quebec opted for in lieu of a portion of federal cash contributions under the Canada Assistance Plan and Hospital Insurance. The latter contributions were subsequently rolled into Established Programs Financing.

Determination of Tax Effort

A comparison of provincial tax rates on individual revenue sources is often employed as a gauge of relative revenue-raising efforts. However, such comparisons alone do not provide a way of assessing a province's overall tax effort.

As with the determination of fiscal capacity, tax effort can be measured by individual revenue sources. For each revenue source, a national average tax rate can be calculated by dividing the provincial revenues collected by the total all-province tax base.

A comprehensive measure of tax effort can be calculated by dividing a province's share of total provincial-local revenues by its share of total tax base. In order to determine a province's share of the aggregate tax base, each of the revenue sources must be weighted to reflect the relative importance that is attached to them individually. For example, if Personal Income Tax (PIT) revenues account for 26 per cent of the total ten-province revenues, the weight of PIT in the comprehensive tax base would be 26 per cent. Each province's share of this weighted tax base is calculated by multiplying its percentage share of the PIT base by this weighted percentage. In the case of Ontario, the Province's share of the PIT base, 41 per cent, is multiplied by the weighted PIT base of 26 per cent to derive Ontario's percentage share of the PIT portion of the comprehensive tax base (i.e., 10.7 per cent). Ontario's share of the comprehensive tax base is determined by summing together the individual percentage shares of the 39 revenue source comprehensive tax base components.

This measure of tax effort indicates to what extent a province is taxing what is available to be taxed, relative to the national average. Local revenues are included because of the varying responsibilities that individual provinces allocate to their local governments. Table 4 provides the indices of relative tax effort for 1985-86 on this comprehensive basis.

Indices of Provincial-Local Tax Effort, 1985-86 — **Table 4**

(Per Cent of National Average)

Newfoundland	103.8
Prince Edward Island	91.0
Nova Scotia	96.7
New Brunswick	98.1
Quebec	125.8
Ontario	**100.7**
Manitoba	104.6
Saskatchewan	99.3
Alberta	74.5
British Columbia	92.4
National Average	100.0

Source: Department of Finance.

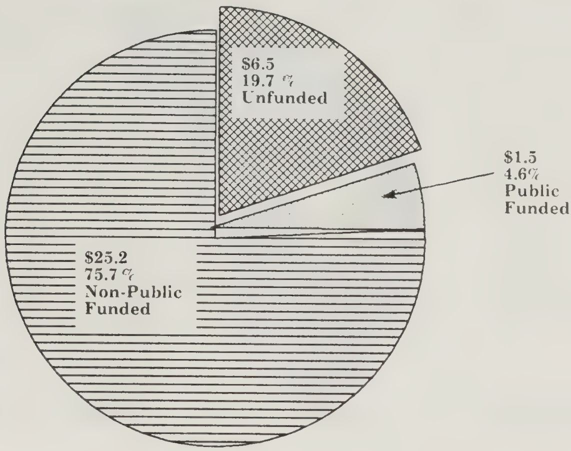
Ontario's overall tax effort is approximately at the national average. Alberta's tax effort is about 25 per cent below the national average, mainly because it levies no sales or gasoline tax, and has the lowest personal income tax. Since Alberta's share of oil and gas revenues is about the same as its share of oil and gas tax bases, its resource taxation does not bias its tax effort one way or another.

Quebec has a very high tax effort, some 26 percentage points above the national average in 1985-86. Despite high rates of taxation on certain revenue sources, the Maritime provinces do not have a high degree of overall tax effort, due in large part to their relatively low levels of local property taxation.

Debt and Debt Financing*

Ontario's Debt

COMPOSITION OF ONTARIO'S OWN-PURPOSE TOTAL DEBT
March 31, 1986
($ Billion)



Source: Ontario Ministry of Treasury and Economics.

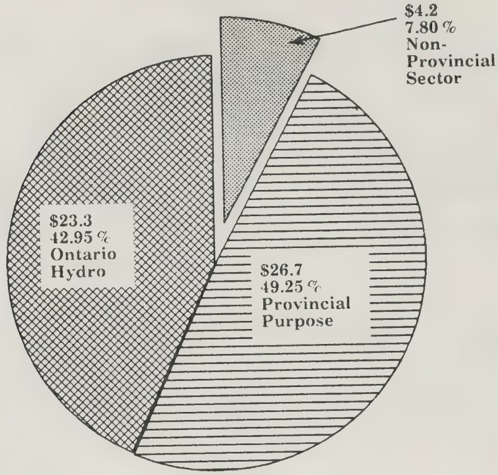
Ontario's own-purpose total debt consists of funded and unfunded debt. Funded debt, the largest portion, has a specified term to maturity and is secured by a debt instrument such as a bond or Treasury Bill. Ontario's funded debt is concentrated in non-public debt, owed primarily to the Canada Pension Plan (CPP) and the Teachers' Superannuation Fund (TSF) in the form of long-term, non-marketable securities at market-related rates of interest. Debt owed to the general public is about 5.0 per cent of the Province's total debt. The Province's estimated funded debt at March 31, 1987 will be $28 billion of which about 90 per cent will be owed to the CPP and TSF.

Unfunded debt refers to obligations that are not secured by a debt instrument such as deposits with the Province of Ontario Savings Office and for the Public Service Superannuation Fund. Unfunded debt represents about 20 per cent of Ontario's total debt, up from 15 per cent ten years ago. Ontario's own-purpose total debt will be about $35.4 billion by the end of fiscal 1986-87 compared to $14.5 billion ten years ago.

* All Ontario debt figures for 1986-87 are based on the September 30, 1986, Ontario Finances.

Consolidated Public Sector Funded Debt

CONSOLIDATED PUBLIC SECTOR FUNDED DEBT
March 31, 1986
(Interim, $ Billion)

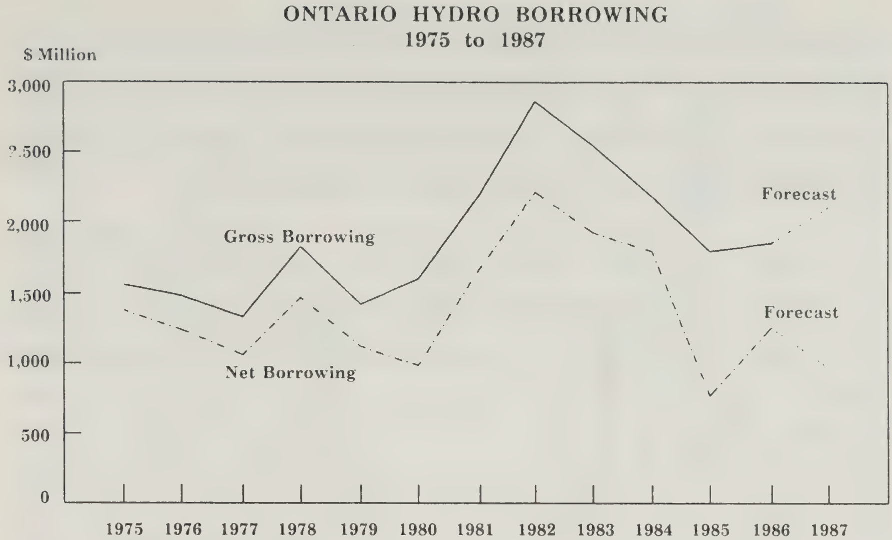


Source: Ontario Ministry of Treasury and Economics.

The broadest measure of funded debt in the Ontario public sector is Consolidated Public Sector Funded Debt which includes debt incurred at all levels of provincial jurisdictions. The preponderance of Provincial and Provincially guaranteed debt in this measure illustrates Ontario's policy of centralizing public sector financing at the Provincial level. Ontario's direct and guaranteed funded debt, which is over 90 per cent of the consolidated debt, consists of obligations for the Province's own purpose or for Ontario Hydro. Due to Ontario's policy of centralized financing, there is a limited requirement for public borrowing by local bodies, universities, colleges and hospitals. Internal funds and Provincial grants finance a large proportion of local capital expenditures, with the remainder financed by borrowing. Local government debt is about 5.0 per cent of consolidated funded debt while less than one-half of one per cent consists of the obligations of universities, colleges and hospitals. The Provincial (direct and guaranteed) share of Consolidated Public Sector Funded Debt has been rising over time reflecting the policy of centralized financing.

Hydro Borrowing

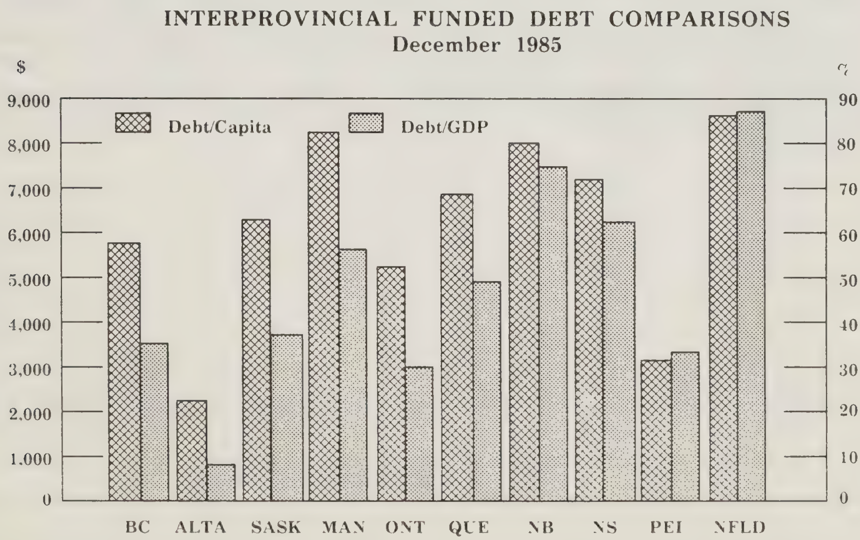
In 1986 and 1987, Ontario Hydro's gross borrowing is expected to be around $2 billion per year, with borrowing net of retirements falling to an average of about $1.1 billion per year. Even though it is unlikely that Hydro's gross borrowing needs will put undue pressure on the capital markets, the Province will continue to monitor Hydro's financing needs and plans to



Source: Ontario Hydro.

ensure that they are consistent with the Province's fiscal and financial plans.

Interprovincial Comparisons



Source: Bank of Canada Review.

Interjurisdictional debt comparisons usually focus on funded debt measures because this assures a standard of conceptual uniformity and comparability

across jurisdictions and over time. Similarly, in order to avoid the inconsistencies caused by provinces assuming different types of debt at different levels of the public sector, the sum of funded debt owed by a province and debt guaranteed by a province is used in interprovincial comparisons. Nevertheless, the comparisons remain limited by differences in treatment across provinces of sinking funds and purchases by public sector investment funds such as the Alberta Heritage Fund.

Ontario's direct and guaranteed debt burden is relatively low compared to other provinces. In 1985, Ontario owed $5,241 per person. This was the third lowest level of direct and guaranteed debt per capita in Canada, higher only than Prince Edward Island and Alberta. Ontario had the second lowest level of debt as a per cent of Gross Domestic Product (30 per cent), after Alberta.

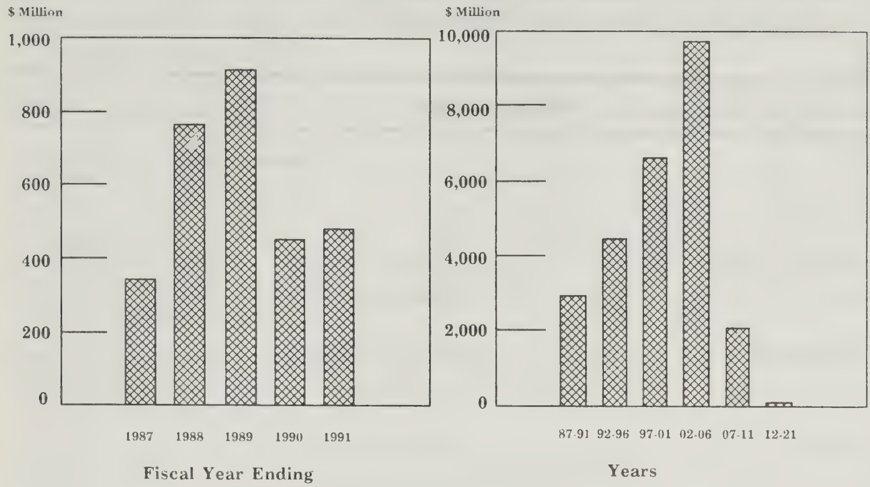
Ontario's Financing

The Province of Ontario has available for its financing purposes the funds of the Teachers' Superannuation Fund (TSF) and Ontario's share of the Canada Pension Plan (CPP) as well as domestic and international capital markets. Because of the structure of contributions and benefits of these two pension plans, they have been a growing source of financing for Ontario. In 1986-87, non-public availability exceeded the Province's needs and consequently, Ontario has not taken all of the CPP funds available to it.

Ontario's Maturing Debt

Approximately 11 per cent of Ontario's funded debt (excluding Treasury Bills) is scheduled to mature in the five-year period from March 1987 to March 1991 and 29 per cent in the ten years from 1987 to 1997. In the next five years, maturities (excluding Treasury Bills) will average about $600 million per year of which $400 million represents retirements of Canada Pension Plan obligations.

ONTARIO DEBT MATURITY



Source: Ontario Ministry of Treasury and Economics.

Credit Worthiness

Provincial Ratings October 1986 — **Table 5**

	Standard and Poor's (S&P)	Moody's	Canadian Bond Rating Service (CBRS)
British Columbia	AA	Aal	AA
Alberta	AA +	Aal	AAA
Saskatchewan	AA	A1	AA
Manitoba	A +	A1	AA-
Ontario	AA +	Aaa	AAA
Quebec	AA-	Aa3	A
New Brunswick	A +	A1	A
Nova Scotia	A-	A2	A-
Prince Edward Island	NR*	A3	BBB +
Newfoundland	A-	Baal	BBB

* Not Rated.

Source: Ontario Ministry of Treasury and Economics, Canadian Bond Rating Service, Moody's Bond Survey and Standard and Poor's CreditWeek.

The 1980s have been a period of general pressure on Canadian provincial credit ratings. Since 1985, seven provinces have been downgraded by Standard and Poor's and Moody's, two U.S. rating agencies, because their economic performance has been weak or their fiscal and financial performance has not matched their economic improvements.

In mid-1986, Ontario was upgraded by the Canadian Bond Rating Service to an unqualified AAA from AAA-. In addition, Moody's raised Quebec to Aa3 from A1 and New Brunswick to A1 from A2.

Rating Adjustments in 1985 and 1986 **Table 6**

	Rating Change	
British Columbia	Downgraded from:	AA+ to AA (S&P)
Alberta	Downgraded from:	Aaa to Aa1 (Moody's) AAA to AA+ (S&P)
Saskatchewan	Downgraded from:	AA+ to AA (S&P) Aa1 to Aa3 (Moody's) Aa3 to A1 (Moody's) AA+ to AA(CBRS)
Manitoba	Downgraded from:	AA- to A+ (S&P) Aa to A1 (Moody's)
Ontario	Downgraded from: Upgraded from:	AAA to AA+ (S&P) AAA- to AAA (CBRS)
Quebec	Upgraded from:	A1 to Aa3 (Moody's)
Nova Scotia	Downgraded from:	A to A- (S&P)
New Brunswick	Upgraded from:	A2 to A1 (Moody's)
Newfoundland	Downgraded from:	A to A- (S&P) BBB+ to BBB (CBRS)

Source: Ontario Ministry of Treasury and Economics, Canadian Bond Rating Service, Moody's Bond Survey and Standard and Poor's CreditWeek.

Federal-Provincial Funding Programs

The following sections describe the two major programs through which the Province receives substantial federal funding: the fiscal arrangements and the Canada Assistance Plan.

Federal-Provincial Fiscal Arrangements

Introduction

The federal-provincial fiscal arrangements are the institutional vehicles through which the federal government transfers funds to the provinces as part of its historical commitment to certain national shared-cost programs, and to the principle of interprovincial fiscal capacity equalization. The largest of these payments is made in respect of health care and post-secondary education under EPF. Funds are also transferred under the Equalization program, the Fiscal Stabilization program, and the Personal Income Tax Revenue Guarantee.

Although often discussed in terms of federal-provincial negotiation and agreement, it should be noted that the fiscal arrangements are under the sole legislative and administrative control of the federal government. Every five years, legislation in this area is drafted and enacted by the federal government, and requires no provincial enabling legislation, support or even agreement to operate. In practice, however, Ottawa has consulted with the provinces on potential revisions to the legislation prior to enactment. Although these negotiations are currently underway, the 1987 fiscal arrangements legislation is not expected to differ fundamentally from what is now in place.

Established Programs Financing

Adopted in 1977 to replace the federal-provincial shared-cost programs in the fields of health and post-secondary education, EPF was regarded as a milestone in co-operative federalism in Canada. The essence of the new arrangement was that the provinces, long dissatisfied with the cumbersome and inflexible nature of the cost-sharing arrangements, were given greater policy and administrative latitude through a move to block funding. At the same time, Ottawa lessened its financial risk by tying its contributions to the rate of growth of the national economy rather than to provincial expenditures.

At a Conference of First Ministers held in June 1976, the broad framework for EPF was introduced. At that time, the Prime Minister outlined five principles that would form the basis of the federal approach*:

* Statement tabled by Prime Minister of Canada, the Right Honourable Pierre Elliott Trudeau, on the occasion of the Conference of Federal and Provincial First Ministers, held at Ottawa, June 14 and 15, 1976.

- The federal government should continue to pay a substantial share of program costs.
- The federal payment should be calculated independently of provincial program expenditures.
- There should be greater equality, in per capita terms, in the federal contributions to the provinces.
- The arrangements for the mature programs should be placed on a more permanent footing.
- There should be provision for continuing federal participation in the development of policies of "national significance" in health and post-secondary education.

The Prime Minister also emphasized that the federal government intended to encourage provincial spending restraint through the new arrangement.

There was widespread provincial acceptance of most of these principles, and a federal-provincial consensus on the course that was being charted. However, shortly after the new arrangement had been agreed upon, the federal government decided to keep track of the individual cash components of the transfers for health and post-secondary education. While not consistent with the principle of block funding, the split was for federal bookkeeping purposes only and did not require provinces to demonstrate that they had, in fact, spent the funds in these areas.

The Canada Health Act is illustrative of federal government attempts to "reconditionalize" EPF. Passed by Parliament in 1984, the Act sets program criteria and conditions of payment for the cash portion of transfers paid to the provinces for insured health care services and extended health care. Under the terms of the legislation, each province's health insurance plan must satisfy federal requirements respecting comprehensiveness, portability, universality, accessibility and public administration.

The federal government is empowered to withhold a portion of the provincial transfer payments equal to the amount that physicians bill above the rates set out in the provincial fee schedules. Dollar for dollar deductions are also imposed on provinces which permit user charges. Between July 1984 and June 1986, over $106 million in payments to Ontario were withheld by the federal government. The Province has since complied with the conditions of the Canada Health Act by eliminating extra-billing for insured health services, and has recouped the amount withheld.

As shown in Table 7, the federal government has taken a number of further actions to restrain the growth of its payments to the provinces. When the fiscal arrangements were amended in 1982, the Revenue Guarantee Compensation, which was built into EPF as part of the 1977 agreement, was removed. This effectively eliminated a portion of the per capita entitlements.

EPF transfer growth is based on both growth in the economy and population increases for individual provinces. Under the two-year federal "6 & 5"

restraint program introduced in June 1982, per capita limits were imposed on post-secondary education transfer growth.

Most recently, the federal government's Bill C-96, An Act to amend the Federal-Provincial Fiscal Arrangements and Federal Post-Secondary Education and Health Contributions Act, 1977, received Royal Assent in June 1986. It reduces the annual growth in per capita EPF transfers by two percentage points. In 1986-87, Bill C-96 will reduce Ontario's EPF entitlements by $317 million. Taken together, the reductions in EPF entitlements for Ontario amount to $642 million in 1986-87.

Provincial Losses Due To Federal EPF Cuts Since 1982 — **Table 7**

($ Million)

	Elimination of Revenue Guarantee Compensation		"6 & 5" Caps on PSE Transfers		Reduction of EPF Escalator	
	Ontario	All Provinces	Ontario	All Provinces	Ontario	All Provinces
1982-83	294	828	–	–	–	–
1983-84	325	914	45	125	–	–
1984-85	357	999	94	264	–	–
1985-86	384	1,071	101	283	–	–
1986-87	417	1,158	110	306	115	317
TOTAL	1,777	4,970	350	978	115	317

Source: Department of Finance and Ontario Ministry of Treasury and Economics.

Federal support for Ontario health and post-secondary education programs has fallen from a peak of 52 per cent of provincial spending for these purposes in 1979-80, to about 43 per cent in recent years. Because EPF tax point transfers are derived from provincial taxpayers, they can be regarded as provincial revenues. Thus, if the federal contribution is considered solely in terms of the EPF cash component, then Ottawa's current share of combined health and post-secondary education spending in Ontario would amount to only 25 per cent, down from 30 per cent in 1979-80.

Equalization

Equalization payments are unconditional transfers from the federal government to qualifying provinces, with the purpose, as enshrined in Section 36 of the Constitution Act, 1982, of ensuring that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation. The

actual determination of equalization entitlements has evolved over the years by refinements and adjustments to the formula since the inception of the program in 1957. Although there have been disagreements about these changes, some of which had quite dramatic effects, all provinces have supported the overall thrust of the program.

Ontario has never been an equalization recipient. Indeed, when oil price shocks created this possibility, these equalization payments were prevented through retroactive legislative amendment in 1981.

Determining the extent to which the goals of equalization are being achieved is difficult due to the lack of a definition or measure of "reasonably comparable levels of public services at reasonably comparable levels of taxation". As was discussed in the section on fiscal capacity and tax effort, the equalization program takes into account 39 distinct revenue sources. These sources and the estimated provincial revenues to be equalized for 1986-87 are summarized in Table 8.

Fiscal Equalization, 1986-87 — **Table 8**

($ Billion)

Revenue Source	Amounts Subject to Equalization
Personal Income Tax Revenues	22.1
Business Income Revenues	4.6
Capital Tax Revenues	1.2
General and Miscellaneous Sales Taxes	13.5
Tobacco Taxes	2.0
Gasoline Taxes	2.6
Diesel Fuel Taxes	0.7
Non-Commercial Vehicle Licences	1.2
Commercial Vehicle Licences	0.5
Revenues from the Sale of Spirits	1.6
Revenues from the Sale of Wine	0.5
Revenues from the Sale of Beer	0.8
Hospital and Medical Insurance Premiums	2.2
Succession Duties and Gift Taxes	*
Race Track Taxes	0.1
Natural Resource Revenues **	4.3
Insurance Premium Revenues	0.5
Payroll Taxes	1.9
Provincial-Local Property Tax Revenues	16.1
Lottery Revenues	0.9
Miscellaneous Provincial-Local Taxes and Revenues	7.5
Shared Revenues: Undistributed Income on Hand	*
Shared Revenues: Off-shore Activities	*
TOTAL	84.9

Notes: * Less than $50 million.
** The 17 separate natural resource revenue sources have been aggregated.

Source: Department of Finance, Provincial Fiscal Equalization, Second Estimate, 1986-87 (July, 1986).

This set of revenue sources is known as the Representative Tax System (RTS), since it attempts to take into consideration what provinces, as a

whole, actually tax. Each of the revenue sources has an associated tax base. For example, the base for revenues from the sale of beer is the volume of beer sold.

The tax bases have been modified over the years. Discussions continue on technical problems that are perceived to remain in the determination of appropriate components to use in some tax bases to satisfy the requirement of making them "representative". For example, there is currently a debate on the property tax base; since there is no comparable interprovincial property tax base, the equalization formula has had to rely on proxies for the assessed values of land and buildings. The particular proxies used in the property tax base are the subject of some concern. For instance, the use of Gross Domestic Product (GDP) as a proxy for residential land values has been criticized since the housing component of GDP is relatively insignificant.

For each revenue source, a national average tax rate is calculated by dividing the total revenues to be equalized by the total all-province tax base. Comparisons can be made among provinces by applying the national average tax rate for each revenue source to individual provincial tax base values on a per capita basis.

The equal yield per capita standard that the equalization formula sets must then be determined.

The current benchmark that is applied to each province for each revenue source is termed the "five-province standard"; this standard is derived by applying the national average tax rate to the tax bases of Quebec, Ontario, Manitoba, Saskatchewan and British Columbia and calculating the per capita yield for the five provinces.

Finally, the difference between this standard per capita yield and a province's own per capita yield provides its relative per capita deficiency or surplus for each of the 39 sources.

Two examples to illustrate this process:

- In calculating the latest estimate for 1985-86 national average tax rates, the Newfoundland provincial income tax (PIT) base yields $431.71 per capita. The national average tax rate applied to the five-province standard tax base yields $815.40 per capita. This means that Newfoundland has a PIT deficiency of $383.69 per capita ($815.40 - $431.71). Newfoundland's equalization component in respect of PIT, $223 million, is then calculated by multiplying its per capita deficiency by its population.
- Conversely, Ontario's yield at the national average tax rate is $920.21 per capita. Since this yield is above the $815.40 per capita that results from applying the national average tax rate to the five-province standard, Ontario has a PIT excess of $104.82 per capita.

The calculation of a deficiency for a province for a particular revenue source does not necessarily mean that the province will receive equalization payments. The size of equalization entitlements is determined by the

netting of all negative and positive entitlements. In Ontario's case, for example, although the formula indicates a deficiency in the oil and gas revenue sources, negative entitlements in other sources are sufficiently large to negate entitlement to equalization on an aggregate basis.

The current "five-province standard" replaced a national average standard in 1982. This change, combined with a number of tax base modifications, tended to disadvantage Quebec and Manitoba. Accordingly, a three-year transitional guarantee was incorporated into the formula.

The transitional guarantee provided that no province could receive less under the new formula than it received in the last year of the old formula. Provision was made for a specified amount of growth.

This provision lapsed at the end of the 1984-85 fiscal year, at an estimated three-year cost to the federal government of $2.1 billion. All equalization recipients received transitional guarantee payments.

As shown in Table 9, following the lapse of the transitional program, additional supplementary equalization payments totalling $220 million were made to the six recipient provinces in respect of the 1985-86 fiscal year. One year later, Manitoba received an additional $65 million in supplementary equalization.

Supplementary Equalization Payments **Table 9**
($ Million)

	1985-86	1986-87
Newfoundland	15	–
Prince Edward Island	5	–
Nova Scotia	20	–
New Brunswick	20	–
Quebec	110	–
Manitoba	50	65
TOTAL	220	65

Source: Department of Finance.

The sole legislative constraint on the growth of equalization entitlements is that aggregate transfers must not exceed the year-over-year increase in Gross National Product (GNP). So far, this ceiling has not had to be applied.

For 1986-87, the current estimate of equalization entitlements is $5.3 billion. Although Quebec receives the greatest share of total equalization, on a per capita basis it receives the least. Table 10 shows the breakdown of the estimated 1986-87 entitlements among the provinces as well as the entitlements on a per capita basis.

Estimated Equalization Entitlements by Province, 1986-87 — Table 10

	$ Million	$ Per Capita
Newfoundland	670	1,151
Prince Edward Island	139	1,082
Nova Scotia	610	687
New Brunswick	640	885
Quebec	2,737	413
Manitoba	504	467
TOTAL	5,300	529

Notes: Ontario, Saskatchewan, Alberta and British Columbia have net negative entitlements and do not receive equalization payments.

Manitoba's entitlement includes $65 million in supplementary payments.

Source: Department of Finance, Provincial Fiscal Equalization, Second Estimate, 1986-87 (July, 1986).

Fiscal Stabilization

In order to protect provinces from sudden year-over-year losses in revenue resulting from an economic downturn, the federal government has provided for fiscal stabilization payments. These unconditional cash transfers ensure that each province's tax revenues, measured on the basis of constant tax rates and structure, plus its equalization payments, will not be less than they were in the previous year.

To date, only one province has received payments under this program -- British Columbia received $175 million in respect of the 1982-83 fiscal year. However, fiscal stabilization payments provide an important guarantee for many provinces when their credit ratings are under review.

Personal Income Tax Revenue Guarantee

Provincial Personal Income Tax Revenue Guarantee payments ensure that provinces will not suffer a reduction in personal income tax revenues due to amendments to the federal Income Tax Act. Should federal actions reduce a province's personal income tax revenues by more than 1.0 per cent from the preceding year, that province becomes eligible for a federal revenue guarantee payment. The amount of the payment would be the difference, exceeding 1.0 per cent, between the amount of tax which would have been raised under the federal legislation prior to amendment and the amount raised subsequent to amendment.

Canada Assistance Plan

The Canada Assistance Plan (CAP) was established by federal legislation in 1966 as a cost-sharing mechanism for provincially-administered social assistance and welfare programs. CAP replaced the existing targetted shared-cost programs which provided assistance for the elderly, the blind, the disabled and the unemployed. By the end of the 1960s, these programs had come under increasing criticism for their eligibility restrictions. The new program was designed to bring a measure of order and coherence to fragmented provincial public assistance systems.

Since its inception, payments under CAP have grown dramatically, increasing from $343 million in 1967-68 to $4 billion in 1985-86. This makes CAP the third largest source of transfers to the provinces after Established Programs Financing and Equalization. In Ontario alone, CAP payments will exceed $1 billion for 1985-86.

CAP is intended to act as a last resort safety net. Under its provisions, the federal government contributes an amount equal to 50 per cent of provincial expenditures on assistance payments (food, shelter and clothing) to individuals in need, and a range of welfare services, including child welfare, day care, homemaker services for the elderly, institutions for the disabled and family counselling. To qualify for federal CAP funds, provincial programs must be designed to benefit those "in need or likely to become in need". As well, potential beneficiaries must demonstrate their eligibility through either a needs test or an income test, as determined by each province and subject to federal guidelines.

Although the Canada Assistance Plan stands out as a highly successful example of federal-provincial co-operation, the program has been the subject of numerous reviews during the last two decades. In 1970-71, the Senate Committee on Poverty issued a report that was critical of CAP and recommended that it be replaced by a guaranteed annual income. Ten years later, negotiations were underway to remove social services from CAP and provide them through a block fund under a proposed Social Services Financing Act modelled on EPF. The proposal, however, was withdrawn when the provinces refused to accept a reduction in the EPF escalator to GNP growth less one per cent. The proposal to replace the federal share of CAP and other federal tax and transfer programs, such as family allowances and child tax credits, with a guaranteed annual income, was resurrected by the Macdonald Commission in 1985 when it recommended the adoption of a Universal Income Security Program.

More recently, the Nielsen Task Force on Program Review found no support for a major revision of CAP. However, its report did register concern over the trend toward long-term dependence on assistance among "employables" and warned of the danger that future CAP costs may become unaffordable as a result. The Nielsen review concluded that it may be necessary to change the open-ended nature of CAP funding by limiting federal spending under the agreement. Increasingly, the limits inherent in CAP's welfare orientation are becoming more evident as priorities in the areas of child care and family violence are pushed to the foreground.

Provincial-Local Transfers

In 1986-87, the Province will provide $3.4 billion in financial support to municipalities and municipal agencies, as indicated in Table 11. Program assistance ranges from a low of a few thousand dollars to a high of almost $800 million, and is made available through more than 100 programs.

Provincial support to school boards amounts to more than $3.4 billion, including some $100 million in capital assistance.

Highlights of Provincial Transfers to Local Governments — **Table 11**

($ Million)

	Outlook 1986-87
Transfers to Municipalities	
Unconditional	780
Roads	547
Transit	261
Social Services	1,050
Health	160
Environmental	112
Recreational & Cultural	75
Other	361
Ontario Municipal Improvement Fund	60
Total Municipal Transfers	3,406
Transfers to School Boards	
General Legislative Grants	3,329
Capital Grants	108
Total School Transfers	3,437
Total Transfers to Local Government	6,843

Source: Ontario Ministry of Treasury and Economics.

Transfers to Municipalities

Transfer payments to municipalities are estimated to increase by 5.4 per cent in 1986-87.

The average annual growth in Provincial support to the municipal sector has outpaced inflation since the beginning of the decade. As Table 12 indicates, total operating transfers increased faster than the rate of inflation, while the growth in capital transfers was lower than the growth in

CPI, reflecting the fairly stable pattern of Provincial capital activity in general.

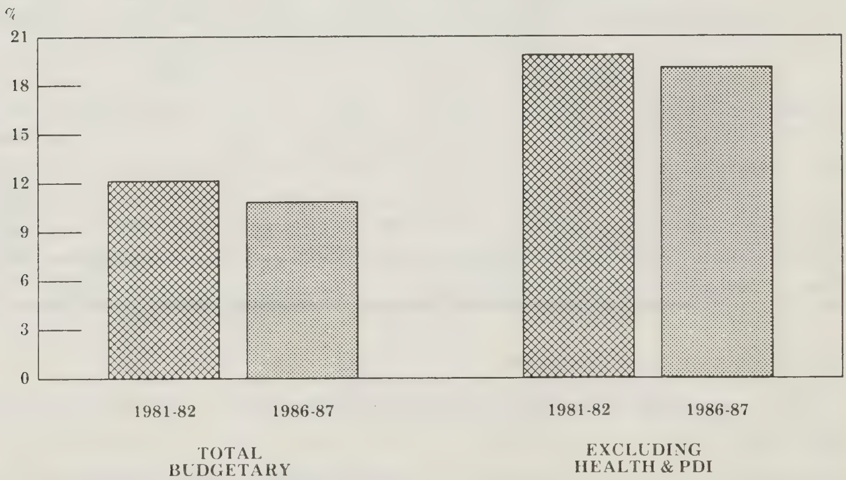
Provincial Transfers to Municipalities **Table 12**

($ Million)

	1981-82	Outlook 1986-87	Average Annual Increase (%)
Unconditional	637	780	4.1
Conditional	943	1,671	12.1
Total Operating	1,580	2,451	9.2
Capital	813	895	1.9
Total Transfers	2,393	3,346	6.9
Ontario Municipal Improvement Fund	–	60	–
Enriched Total Transfers	2,393	3,406	7.3

Source: Ontario Ministry of Treasury and Economics.

PROVINCIAL TRANSFERS TO MUNICIPALITIES AS A PER CENT OF PROVINCIAL SPENDING



Source: Ontario Ministry of Treasury and Economics.

Municipal Sector Performance

Municipal spending in 1986 is expected to grow by 7.9 per cent. This growth is being led by the areas served by regional government and by Metro

Toronto, which account for 71 per cent of municipal spending. These areas are generally experiencing above-average service growth as measured by the growth in households. It should also be noted that individual municipal patterns of growth within these areas can vary considerably. By comparison, Table 13 shows that for the rest of the province, spending growth is expected to average around 6.8 per cent.

Estimated Municipal Spending, 1985 & 1986 — **Table 13**

($ Million)

	1985	1986	Increase (%)
Metropolitan Toronto	3,110	3,364	8.1
Other Regional Governments	3,633	3,946	8.6
All Regional Governments	6,743	7,310	8.4
Cities Not Part of Regional Governments	1,357	1,441	6.2
All Other Municipalities	1,450	1,556	7.3
Non-Regional Governments	2,807	2,997	6.8
Total Municipal Sector	9,550	10,307	7.9

Source: Ontario Ministry of Municipal Affairs.

Since 1981, Provincial transfers have almost kept pace with the growth in overall local spending. As shown in Table 14, the proportion of municipal financing accounted for by transfers has dropped slightly over the period, with the difference being made up by municipal property taxes.

Municipal Revenue Mix — **Table 14**

(Per Cent)

	1981	1986
Property Taxation	35.3	36.7
Provincial Grants	31.4	30.9
All Other Revenues	33.3	32.4
	100.0	100.0

Source: Ontario Ministry of Municipal Affairs.

Since 1970, property tax burdens (taxes in relation to household incomes) have remained below the 3.0 per cent level, and are now approximately 2.6 per cent. However, over the past three years, overall mill rate increases (including school taxes) have outpaced the growth in both inflation and incomes. School taxes have contributed more to the recent rise in local

taxation, growing 9.0 per cent for an average household on an annual basis since 1981, compared to 7.3 per cent annual growth in municipal taxes.

Education Finance

The funding of elementary and secondary education in Ontario is shared between the Province and local school boards. The Provincial share is distributed to school boards through the General Legislative Grants with the school board share being raised from local property taxes. School funding is a significant component of government spending at both levels, as shown in Table 15.

Education Finance in Perspective **Table 15**

(Per Cent)

	1986-87
Transfer Payments to School Boards	
Relative to Total Local Transfers	50.2
Relative to Provincial Budgetary Expenditure	11.0
School Finance in the Local Sector	
School Board Operating Spending Relative to Total Local Operating Spending	45.8
School Taxes Relative to Total Local Property Taxes	50.5

Source: Ontario Ministry of Treasury and Economics.

Appendices

GLOSSARY OF TERMS

Ad Valorem Tax - A percentage-based tax, typically applied to a measure of value such as selling price.

Basic Federal Tax - The level of tax determined by applying the federal tax rate schedule to taxable income. It is not federal tax payable, which is basic tax adjusted by credits, surtaxes or reductions. Ontario's tax rate of 50 per cent is applied to Basic Federal Tax to yield Basic Ontario Income Tax.

Canada Assistance Plan - Federal-provincial cost-sharing mechanism for provincially-administered social assistance and welfare programs.

Capacity Utilization Rate - The actual output of an industry as a percentage of the output it could produce with its existing plant, equipment and work force.

Consolidated Public Sector Funded Debt - Funded debt incurred at all levels of Provincial jursidiction including the Province, Ontario Hydro, municipalities, hospitals, universities and colleges.

Consumer Price Index - A monthly index measuring the retail prices of a fixed basket of goods and services purchased by consumers.

Consumption - The value of spending by consumers on goods and services, measured in current dollar terms (nominal) or adjusted for inflation (real). Consumption accounts for approximately 60 per cent of Gross National Product.

Cost-of-living Adjustment - An adjustment to incomes, wages or other payments to maintain previous purchasing power in the face of changing consumer prices.

Debt to Equity Ratio - The total debt of industrial corporations divided by total shareholder's equity.

Deductions - Reductions in the tax base, usually for specific expenses incurred in order to earn income.

Economies of Scale - Reductions in the average cost of production achieved by increasing the volume of output.

Equalization - Unconditional transfers from the federal government to qualifying provinces with the purpose of ensuring that provincial governments have sufficient revenues to provide reasonably comparable levels of public service at reasonably comparable levels of taxation.

Established Programs Financing - Unconditional federal payments to the provinces in respect of health care and post-secondary education.

Exemptions - Amounts deductible from income in recognition of specific personal circumstances.

Expenditures - Expenditures on government programs include payments for goods and services, interest on the public debt, salaries, transfer

payments to individuals, municipalities and institutions, subsidies and grants, the acquisition and creation of fixed assets, and the lending, investment and trust administration activities of the Government.

Export - A good or service which is produced in one country or jurisdiction and sold to another.

Final Demand - Purchases of goods and services within the economy, excluding inventory change.

Final Domestic Demand - Purchases of goods and services within the economy, excluding the foreign sector (exports and imports) and inventory change.

Fiscal Arrangements - Institutional vehicles through which the federal government transfers funds to the provinces as part of its commitment to shared-cost programs and interprovincial fiscal capacity equalization.

Fiscal Capacity - Measure of a province's relative ability to raise revenues from available revenue sources.

Fiscal Policy - The use of the Government's spending and taxing power to regulate the aggregate level of economic activity. Expansionary fiscal policy is generally characterized by an increase in discretionary spending or a tax cut.

Fiscal Stabilization - Unconditional cash transfers from the federal government to ensure that no province's tax revenues, measured on the basis of constant tax rates and structure, plus its equalization payments, will be less than they were in the previous year.

Funded Debt - Debt which has a specified term to maturity and is secured by a debt instrument such as a bond.

Gramm-Rudman - A deficit-trimming formula proposed by U.S. Senators Gramm and Rudman which establishes a schedule of annual deficit reduction targets culminating in a balanced federal budget by 1990. If these targets are not met, the President would be required to achieve them through automatic reductions in most categories of federal government expenditures.

Gross Borrowing - Total borrowing including borrowing necessary for retirement purposes.

Gross Domestic Product (GDP) - The value of goods and services produced within the geographic boundaries of an area.

Gross National Product (GNP) - A nation's total output of goods and services, expressed either in current dollar value (nominal) or adjusted for inflation (real). The percentage change in real GNP is the usual measure of the real growth rate of the economy.

Gross Provincial Product (GPP) - The value of goods and services produced within the geographic boundaries of a province; may be measured in current dollar terms (nominal) or adjusted for inflation (real).

Guranteed Debt - Debt for which the Province agrees to meet the costs if the borrowing party can not; primarily, for Ontario Hydro.

Household Formation - Net increases in new households in a period.

Import - A good or service which has been bought from another country or jurisdiction.

Inflation - A continuing rise in the general price level.

Interest Rate - The price paid (charged) by a borrower (lender) of money. Nominal interest rates are those actually paid; real interest rates are nominal rates less the expected rate of inflation (current rates of inflation are generally used as proxies for expected rates).

Interest Service Ratio - Total interest payments taken as a per cent of cash flow of industrial corporations before interest and taxes are deducted.

Inventory - The various raw materials, parts and finished goods plus work-in-progress of a firm, and their total value.

Inventory Accumulation - An increase in the level of inventories held in the economy.

Investment - The value of spending on capital goods such as houses, plant and machinery and equipment; may be measured in current dollar terms (nominal) or adjusted for inflation (real).

Labour Force - The total number of persons, age 15 and over, who are either employed or looking for work.

Marginal Tax Rates - A schedule of rates used to determine the amount of tax payable at various taxable income levels and on each additional dollar of taxable income.

Monetary Policy - The policies of the central bank (Canada - Bank of Canada; U.S. - Federal Reserve Board) that determine the availability and cost of capital (i.e., interest rates) in the economy. Tight (anti-inflationary) monetary policy restricts growth of the money supply, thus raising interest rates and reducing inflation by squeezing demand from the economy.

Net Borrowing - Gross borrowing less borrowing needed for retirements.

Net Cash Requirements (NCR) - The difference between total revenue inflows to and total expenditure outflows from the Consolidated Revenue Fund.

Nominal (GNP, consumption, etc.) - In current dollars; not adjusted for inflation.

Non-Markebtable Securities - Securities which may not be bought or sold in public capital markets.

Non-Public Borrowing - Borrowing from non-public sources of funds, usually pension funds like the Canada Pension Plan.

OECD Countries, Major - Canada, France, Italy, Japan, United Kingdom, United States, West Germany.

Operating Position - The difference between total current revenues and total current expenditures excluding capital expenditures.

Organization for Economic Cooperation and Development (OECD) - An organization of industrial nations, with a permanent staff of officials, established in 1961 to improve trade and investment flows among its members, to help analyze and deal with balance-of-payments and other economic problems and to coordinate foreign-aid policies.

Own-Purpose Debt - Debt issued by Ontario for Provincial use only. This excludes debt issued by Ontario on behalf of Ontario Hydro.

Paid-Up Capital - For most corporations, paid-up capital funds invested in the corporation by its shareholders and other parties, loans or advances made to the corporation, and its cumulative undistributed corporate profit less its investment in other firms.

Participation Rate - The percentage of the population age 15 and over that is in the labour force.

Payroll Tax - An employment income-based tax, usually a percentage, which may be levied on the employer, employee or on both.

Per Point Yields - An estimate of direct revenue which would be gained or lost for a first unit change in relation to a specified change in tax rates.

Personal Disposable Income - The income remaining to persons for consumption or saving after deduction of income taxes, other personal direct taxes, CPP premiums, etc.

Personal Income - The income received by persons from all possible sources.

Personal Income Tax Revenue Guarantee - Federal program to ensure that amendments to the federal Income Tax Act will not reduce a province's personal income tax revenues by more than one per cent

Personal Savings Rate - Percentage of personal disposable income that is not spent for current consumption.

Prime Rate - The interest rate charged by chartered banks to their most credit-worthy customers.

Productivity - Output per unit of input (labour, capital, energy) employed.

Protectionism - Advocacy of protective tariffs and other barriers to trade as a means of developing national wealth.

Public Borrowing - Borrowing which is done through public capital markets.

Public Debt Interest - Interest paid by Ontario on total debt incurred for its own purpose.

Real (GNP, consumption, etc.) - Adjusted for inflation, constant dollars.

Real Domestic Product (RDP) -Gross domestic product adjusted for inflation.

Recession - A downturn in the business cycle characterized by weak economic activity and high unemployment. Two consecutive quarters of decline are generally considered to indicate a recession.

Recovery - The upturn of the business cycle characterized by an increase in economic activity.

Representative Tax System - A series of thirty-nine distinct revenue sources used to determine what provinces, collectively, tax.

Revenue - Includes revenue raised through taxation, premiums, fees, licences and permits, payments from the Federal Government under the Fiscal Arrangements and shared-cost programs and income from investments and earnings from advances and investments to public sector bodies.

Seasonal Adjustment (seasonally-adjusted) - A statistical adjustment to take account of seasonal factors, such as weather, so that data more accurately reflect underlying trends.

Specific Rate of Tax - A fixed rate per unit, (e.g. cigarettes will be taxed at the rate of 2.7 cent each).

Surtax - A tax additional to basic Ontario or basic federal tax, usually calculated with reference to basic tax or to taxable income.

Tariff - A tax imposed on imported goods, levied either as a percentage of their value or according to the number of units imported.

Tax Base - The taxable value to which tax rates are applied; (e.g. the taxable portion of income; or the value of goods and services taxed under the retail sales tax).

Tax Collection Agreement - The agreement between each province and the federal government that authorizes the federal government to collect that province's personal income tax. Under the current arrangements the provinces agree to calculate their percentage of basic federal tax, effectively waiving all rights to determine the tax base. Provinces are permitted limited credit and surtax/reduction programs. Some provinces have similar arrangements for corporate income taxes.

Tax Credit - A reduction of certain taxes paid, with the amount of the credit determined by a specified formula. The Ontario Tax Credits, for example, offset property and sales taxes for individuals by reducing Ontario personal income taxes. The level of this credit is a function of both the amount of tax paid and the ability to pay of the individual. As a result, credit benefits fall as income rises - effectively redistributing tax burdens in favour of lowest income individuals.

Tax Effort - Measure of the relative extent that a province actually taxes available revenue sources.

Total Debt - Funded and unfunded debt borrowed for the Province.

Unemployment Rate - The number of persons in the labour market who are unemployed, as a percentage of the labour force. The seasonally unadjusted rate is referred to by Statistics Canada as the "actual" unemployment rate.

Unfunded Debt - Debt which is not secured by a debt instrument such as deposits with the Province of Ontario Savings office.

Unit Labour Cost - A measure of productivity calculated by dividing the total wage bill by the total number of units of a good or service produced.

Value-Added - The value of a firm's output minus the value of the inputs it purchases from other firms.

Ten-Year Review of Selected Financial and Economic Statistics
($ Million)

	1977-78	1978-79	1979-80	1980-81
Financial Transactions				
Revenue	11,782	13,233	15,246	16,470
Expenditure	13,544	14,413	15,830	17,273
Net Cash Requirements	1,762	1,180	584	803
Financial Position				
Funded Debt[1] (excluding Ontario Hydro)	12,364	14,037	15,196	16,215
Provincial Debt Transactions (net)	1,506	1,652	1,132	968
Publicly-Held Debt	1,613	1,718	1,307	1,164
Gross Provincial Product (GPP) at Market Prices[2]	81,970	89,702	100,942	112,066
Personal Income[2]	67,417	74,835	83,480	93,868
Population - June (000s)	8,353	8,440	8,501	8,570
Funded Debt Per Capita (dollars)	1,480	1,663	1,788	1,892
Personal Income Per Capita (dollars)	8,071	8,867	9,820	10,953
Net Cash Requirements as a per cent of GPP	2.1	1.3	0.6	0.7
Funded Debt as a per cent of GPP	15.1	15.6	15.1	14.5
Total Expenditure as a per cent of GPP	16.5	16.1	15.7	15.4
Publicly-Held Debt as a per cent of GPP	2.0	1.9	1.3	1.0
Cumulative Net Borrowing for Ontario Hydro				
U.S.	3,284	4,141	4,506	4,379
C.P.P.	–	–	–	500
Contingent Liabilities (mainly Ontario Hydro)	6,557	7,096	7,904	8,553

1 Funded Debt includes debentures, notes and Treasury Bills.

2 Gross Provincial Product and Personal Income are calculated on a calendar year basis. The amounts appearing in a fiscal year column are for the preceding calendar year. Figures for 1984-85 and 1985-86 have been revised.

3 Ontario Finances, September 30, 1986

Note: All funds are quoted in Canadian dollars.

* Before extraordinary adjustments.

** After extraordinary adjustments.

N/A - not available.

Source: Ontario Ministry of Treasury and Economics.

						Interim[3]
1981-82	1982-83	1983-84	1984-85	1985-86*	1985-86**	1986-87
18,886	20,433	22,647	25,196	27,692	30,858	30,353
20,389	22,911	24,936	26,898	29,297	32,968	31,790
1,503	2,478	2,289	1,702	1,605	2,110	1,437
17,592	19,643	22,503	24,593	26,695	26,695	28,026
1,363	2,051	2,860	2,090	2,102	2,102	1,331
1,102	1,056	1,939	1,841	1,520	1,520	1,519
127,408	133,536	148,008	166,879	180,570	180,570	193,390
109,672	121,091	130,333	146,234	158,261	158,261	166,256
8,625	8,716	8,822	8,939	9,059	9,059	9,162
2,040	2,254	2,550	2,751	2,946	2,946	3,078
12,716	13,893	14,773	16,359	17,470	17,470	18,146
1.2	1.9	1.5	1.0	0.9	1.2	0.7
13.8	14.7	15.2	14.7	14.8	14.8	14.5
16.0	17.2	16.8	16.1	16.2	18.2	16.4
0.9	0.8	1.3	1.1	0.8	0.8	0.8
5,573	6,058	6,487	7,206	7,189	7,189	N/A
1,000	1,000	1,000	1,000	1,000	1,000	N/A
9,284	11,122	12,711	14,220	15,963	15,963	N/A

Economic Outlook and Fiscal Review

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Preface

The annual Economic Outlook and Fiscal Review is part of the Government's efforts to enhance the pre-budget discussions and consultative process, leading to the development of Ontario's annual Budget.

In Spring, 1986, the Legislature set up the Standing Committee on Finance and Economic Affairs to "consider and report to the House its observations, opinions and recommendations on the fiscal and economic policies of the Province." This Review has been prepared to assist the Committee, other members of the Legislature and the general public in deliberations and discussions on the forthcoming 1988 Ontario Budget.

The Ontario Economy: Performance and Prospects

Ontario Economic Outlook at a Glance			
	1986	1987	1988
Real Growth (%)	4.9	3.9	2.8
Inflation (%)	4.4	5.1	4.7
Job Creation (000s)	153	146	105
Unemployment Rate (%)	7.0	6.2	5.8

The Ontario economy is heading into its sixth consecutive year of growth.

1987 Performance: Strong Growth

The Ontario economy has continued to grow very strongly in 1987. Ontario's real output for the first six months grew at a rapid 4.4 per cent annual rate. Growth has been driven primarily by strong personal consumption and business investment.

- Ontario retail sales rose by 10.1 per cent during the first nine months of 1987 compared to the same period last year. Strong automotive sales and housing-related expenditures were key factors.
- Business investment is expected to exceed $25 billion this year, supported by solid gains in spending on machinery and equipment and non-residential construction.
- The housing market continues to be strong. Housing starts increased by 40.4 per cent for the first nine months of 1987 compared to the same period in 1986.

Strong economic growth has led to substantial employment gains and a lower unemployment rate.

- In the first eleven months of this year, the Ontario economy created an average of 145,000 jobs.
- The unemployment rate was 5.9 per cent in November, 0.8 percentage points lower than a year earlier.

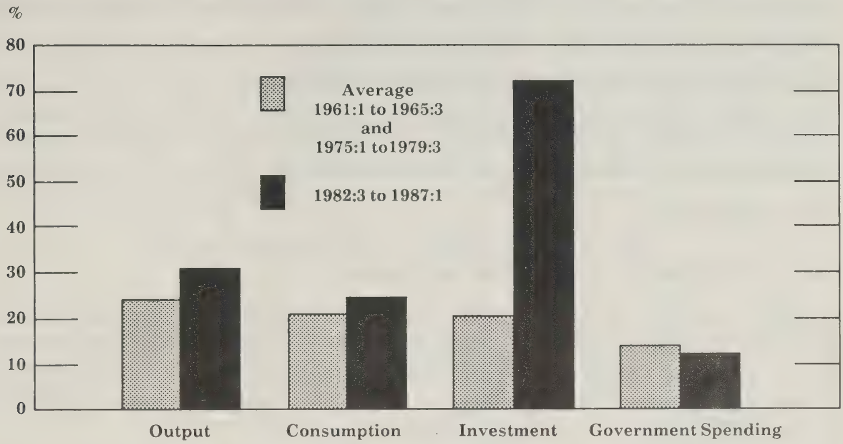
In 1985 and 1986, the Ontario economy outperformed the rest of Canada. Over those two years, Ontario's real output expanded by 10.3 per cent compared to 6.1 per cent for the rest of the country. In 1987, the growth gap narrowed. Real output in Ontario is expected to grow by 3.9 per cent this year compared to 3.5 per cent in the rest of the country.

An Historical Perspective

The current economic expansion has continued without interruption for over five years. This ranks as the second longest expansion since 1950, surpassed only by the 52-quarter expansion spanning the 1961-1973 period.

The first eighteen quarters of the current expansion compare favourably with the first eighteen quarters of the 1961-1973 expansion and the eighteen quarter expansion of 1975-1979. Real output has risen by over 31 per cent, significantly greater than the average 24.2 per cent increase recorded over similar stretches of the two previous lengthy expansions. Job creation has totalled 608,000, significantly more than the average 472,000 jobs generated over the two previous comparable periods.

REAL GROWTH DURING MAJOR EXPANSIONS



Source: Ontario Ministry of Treasury and Economics.

Investment (including residential housing) has also been considerably stronger than in the previous expansions. Spending by all levels of government has grown relatively more slowly over the current cycle, rising by only 12.2 per cent, compared to an average of 14.2 per cent during comparable periods in the 1961-1973 and 1975-1979 expansions.

1988 Forecast: Continued But Moderate Growth

The recent crash of equity values on stock markets around the world has injected a new element of uncertainty into the 1988 forecast. However, despite the uncertainties remaining as a result of the market crash and subsequent reactions, the forecast is that the current expansion of the Ontario economy will continue in 1988, but at a more moderate pace than previously expected.

- Real GDP growth will decelerate from 3.9 per cent in 1987 to 2.8 per cent in 1988.
- Job creation is forecast at 105,000 in 1988, representing a 2.2 per cent increase in employment.
- The unemployment rate in 1988 is expected to average 5.8 per cent.
- CPI inflation in Ontario is forecast to moderate to 4.7 per cent next year.

More details on the Ontario economy's performance in 1987 and an outlook for 1988 are presented later.

Key Factors and Assumptions: 1987-1988

The Ontario economy is highly sensitive to growth in key export markets and changes in important international prices.

- Economic growth in the U.S., Japan and Europe.
- Economic performance in the rest of Canada.
- International and domestic financial markets.
- Energy prices.

The United States, Japan and Europe

Economic growth in the United States has a very strong influence on economic activity in Ontario. Exports to the United States represent about 32 per cent of Ontario's Gross Domestic Product. Every additional percentage point of real growth in the U.S. typically means about 0.4 percentage points of extra real growth in Ontario.

In 1987, economic growth in the U.S. resulted more from U.S. export growth than expansion of domestic demand. The lower value of the dollar bolstered competitiveness and stimulated manufacturing activity. Strong employment gains during the first half of 1987 pushed the U.S. jobless rate below six per cent for the first time in eight years.

After five years of improving price performance, CPI inflation in the U.S. doubled from 1.9 per cent in 1986 to about 3.8 per cent in 1987 in response to increased energy and import costs. Inflation fears and tightening monetary policy by the Federal Reserve Board raised interest rates during the spring and late summer.

After rapid increases in equity prices during most of 1987, the prospects of higher inflation and higher interest rates and the very high price-earnings ratios for equities contributed to the plunge in stock values around the world. In the U.S., the Dow Jones lost over 30 per cent of its peak value by the end of November. To restore confidence and stability, the Federal Reserve, in concert with other central banks, lowered interest rates sharply.

Notwithstanding these policy responses, the stock market crash may have the effect of raising the personal savings rate by over one-half of a percentage point as households reduce spending. This could reduce consumer spending by $20 to $27 billion in 1988.

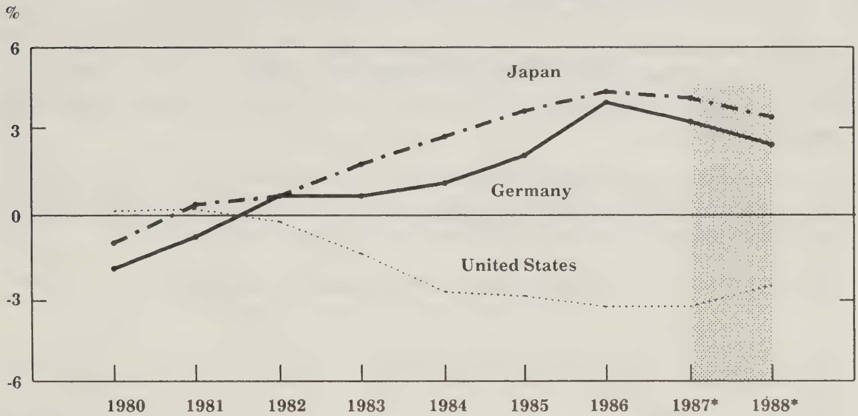
On net, the major drop in equity values has lowered most forecasts of U.S. growth in 1988. The crash has cut forecast growth by slightly more than 0.5 percentage points.

The stock market crash has focussed renewed attention on U.S. fiscal policy. U.S. fiscal policy will become more restrictive in 1988 as a result of efforts to narrow the federal budgetary gap. The recent accord between the Congress and the Administration is expected to lower the federal budget deficit by an estimated $30 billion in fiscal 1988 and $46 billion in fiscal 1989.

Moderate growth should continue in 1988, reflecting the stimulative impact of the improving real trade balance and lower interest rates. Real GNP should post a 2.6 per cent gain in 1987, moderating to 2.3 per cent in 1988.

Since 1980, U.S. economic policies have resulted in both large and persistent federal budget and international payments deficits. As shown in the accompanying graph, large-scale American deficits have been balanced by surpluses in West Germany and Japan. The result has strained the world trading system leading to dramatic increases in U.S. international indebtedness and highly volatile international exchange rates.

CURRENT-ACCOUNT IMBALANCES
(As Per Cent of GNP)



* Forecast
Source: O.E.C.D.

The current account deficit may result in an even further depreciation of the U.S. dollar in relation to the yen and the deutschemark. This emphasizes the need for additional efforts to harmonize monetary and fiscal policies. The United States has called for West Germany and Japan to stimulate their economies. Other countries point to the destabilizing effects of the U.S. budget deficit and the need to reduce that deficit.

Moderate growth is projected to occur in the other major industrial countries. For 1988, the OECD forecasts that Japan's real GDP will grow by 2.0 per cent. The West German and U.K. economies will expand by 2.0 per cent and 2.3 per cent respectively. Continued expansion of the world economy will be essential for resolving major international imbalances, including the U.S. trade deficit and third-world debt.

Next June's G-7 meeting in Toronto will provide a further opportunity to consider coordinated international measures to address these economic imbalances.

Rest of Canada

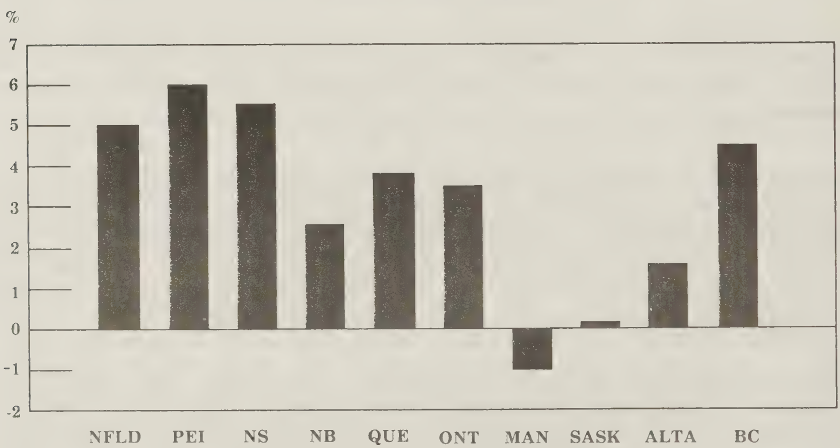
The economic performance of the other provinces has an important bearing on the Ontario outlook. Interprovincial exports of goods and services account for approximately 16 per cent of Ontario's Gross Domestic Product.

The Canadian economy has rebounded sharply from its flat performance over the last half of 1986. Growth in the first half of 1987 was supported by strong gains in consumer and business spending and in residential construction.

While Ontario and Quebec have made a major contribution to national growth this year, there is increasing evidence that the current expansion has broadened beyond Central Canada. A key factor in the surging pace of national economic growth has been a recovery of commodity prices, particularly for metals and forest products. As a result, the outlook for the resource–sensitive economies of Eastern and Western Canada has become more favourable.

- The momentum achieved during the first half of 1987 will sustain the expansion over the balance of the year and in 1988. Real GDP in Canada will advance 3.6 per cent this year and 2.5 per cent in 1988.

PROVINCIAL EMPLOYMENT GROWTH
(OCTOBER 1987 / DECEMBER 1986)



Source: Statistics Canada

The marked turnaround in Canada's economic performance in 1987 is reflected in a steady improvement in the unemployment rate. Canada's unemployment rate has declined from a seasonally-adjusted rate of 9.7 per cent in January to 8.4 per cent in October, the lowest rate since 1981. The seasonally-adjusted unemployment rate for the rest of Canada has fallen sharply from 11.6 per cent in January to 10.1 per cent in October.

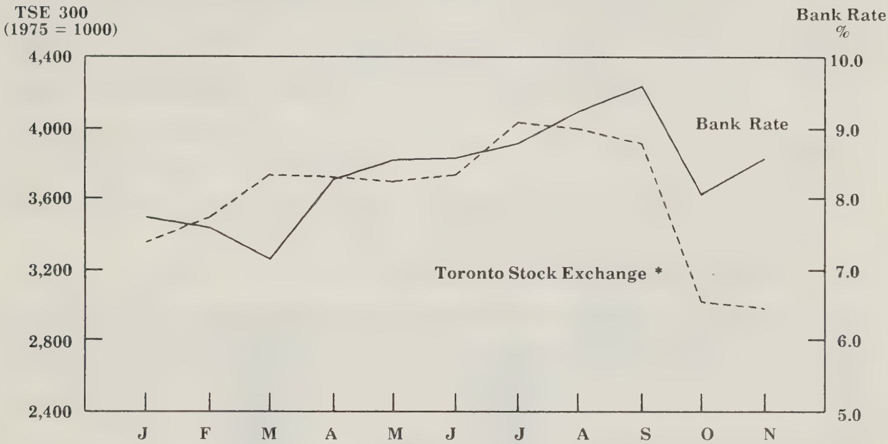
- On an average annual basis, Canada's unemployment rate should decline from 9.0 per cent in 1987 to 8.7 per cent in 1988.

Financial Markets

Central bank policy prior to the stock market downturn had been targetted toward arresting inflationary pressures in the economy. The upward trend in the Bank rate between April and September, in the face of a strengthening Canada-U.S. exchange rate, signalled a shift in the focus of monetary policy from exchange rate stabilization to moderating domestic inflation.

However, the October downturn in world stock markets has led to a sudden decline in interest rates. The sharp 157 basis point reduction in the Bank rate was a timely response by the Bank of Canada to inject liquidity into the financial system to avoid major financial failures potentially created by plunging share values.

TSE 300 and BANK RATE, 1987



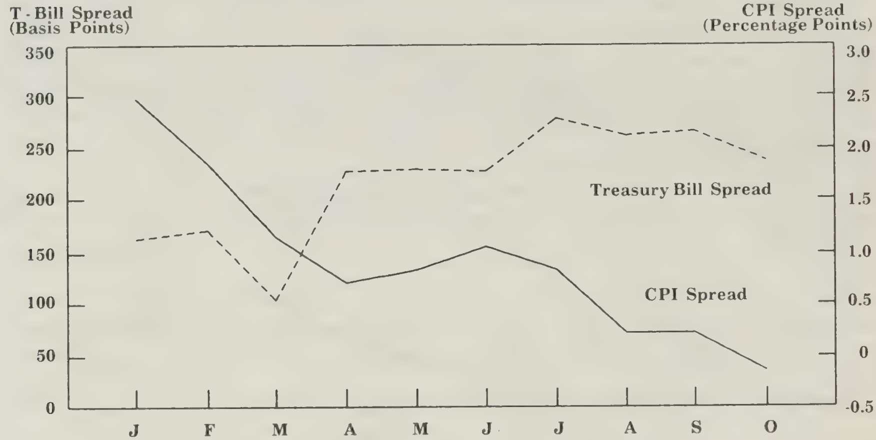
* End of Month.
Source: Bank of Canada.

The recent collapse in stock values and the reduced abilities of firms to raise equity financing will have a negative impact on both consumer and business spending. For example, the market crash has led to a roughly \$70 billion reduction in household wealth in Canada. The effect of this may be to raise savings rates as households attempt to restore gradually their wealth. This lowers current consumption. Some estimates suggest that for every dollar of reduction in wealth, consumer spending is reduced by 4 to 5 cents. This would imply a reduction of consumption of between \$2.8 billion and \$3.5 billion in Canada. There is an additional negative effect of an increase in economic uncertainty on consumer confidence.

While these factors will moderate growth, the underlying momentum of the economy is considerable. (These issues are discussed further in Sources of Growth, pages 9-13.) Moreover, the general economic effects of the drop in stock prices have been counter-balanced by interest rate and exchange rate declines.

As the expansion continues in the Canadian economy, inflation will remain a concern for monetary policy. With the Canadian inflation rate remaining high, Treasury Bill interest rates are expected to rise around 100-200 basis points from current levels. The prime lending rate could return to its pre-October level by the middle of 1988 and rise marginally over the balance of the year.

CANADA - U.S. INTEREST RATE AND CPI DIFFERENTIAL, 1987



Source: U.S. Department of Labour, Statistics Canada, Bank of Canada and Ontario Ministry of Treasury and Economics.

A wide Canada-U.S. interest rate spread, averaging near 200 basis points, and further improvement in commodity prices will support the Canadian dollar in the 75-77 cents U.S. range during 1988. Despite its relative strength against the U.S. currency, the Canadian dollar will continue to depreciate against most major overseas currencies throughout 1988.

Energy Prices

Ontario's import bill for oil and natural gas is expected to be $7.0 billion in 1987, a modest increase from 1986. The price of oil delivered to Ontario refiners is expected to average about $19 U.S. per barrel this year.

Uncertainty in world oil markets is expected to continue through 1988. The primary sources of instability are the Persian Gulf war and continued pressures on OPEC members to exceed current production guidelines. On balance, delivered oil prices should remain in the $19 U.S. per barrel range in 1988.

- The supply of crude oil will remain fairly constant, as both OPEC and non-OPEC producers will avoid major changes to existing production levels.

- While the major industrial economies will continue to grow, the associated growth in crude oil demand will be modest and will not have a major influence on crude prices.

Sources of Growth: 1987-1988

Forecast Overview

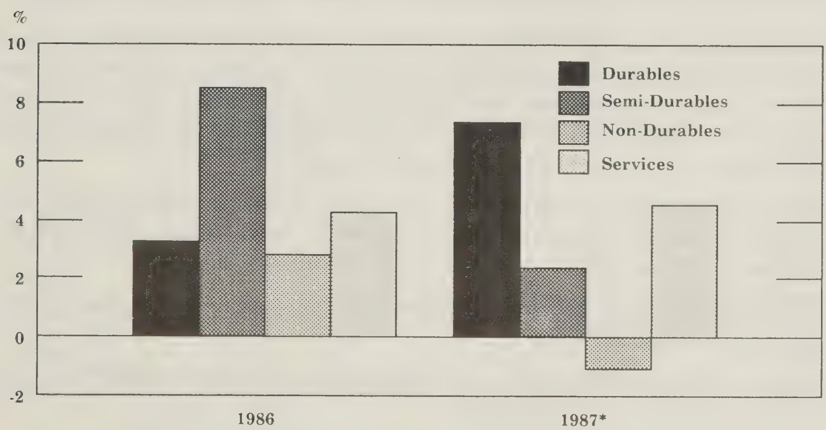
Domestic demand will remain the primary source of economic growth in the province in 1988. Nevertheless, growth in demand will weaken, most notably in consumer spending and housing. Investment growth is also expected to moderate, especially manufacturing investment. Overall, however, investment spending should remain a source of strength in the economy. The trade sector, which exerted a major drag on the economy in 1987, will show a small improvement.

Consumer Demand

Robust growth in personal income and a decline in the savings rate to a 15-year low have fuelled strong consumer spending throughout 1987. Consumption is expected to play a less prominent role in economic growth in 1988. An increase in the personal savings rate and slower employment growth will lead to more modest growth in personal expenditures.

- Growth in real consumption is forecast to decelerate from 4.1 per cent in 1987 to 2.4 per cent in 1988.

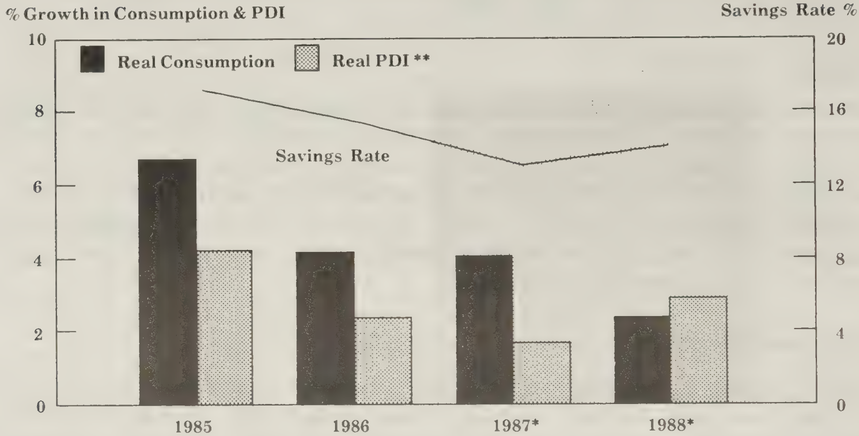
GROWTH IN REAL ONTARIO CONSUMER EXPENDITURE BY TYPE



* First two quarters of 1987 only.
Source: Ontario Ministry of Treasury and Economics.

Spending on services will outpace expenditures on goods. Demand for consumer durables is expected to grow more slowly in 1988, after posting strong growth in 1986 and 1987. Much of the recent strength in durables has been related to the housing boom which is expected to taper off in 1988.

GROWTH IN REAL CONSUMPTION AND SAVINGS RATE



* Forecast
** Personal Disposable Income
Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

Over the last several years, consumer spending increases have outpaced income growth, driving down the personal savings rate. The savings rate is expected to rise in 1988 as consumers adopt a more cautious spending stance.

- Some households suffered a reduction in their net wealth as a result of the stock market crash and will shave their spending in 1988. However, the impact on consumer spending in Ontario should be less than the impact in the United States, as a somewhat smaller percentage of wealth in this country is held in the form of corporate equity.
- The impact of the stock market crash on employment and income in the financial services industry could have a more pronounced effect on Toronto because of the industry concentration in that city.
- The expected rise in interest rates will encourage a higher personal savings rate in 1988.
- Personal income growth is expected to slow marginally from 7.7 per cent in 1987 to 7.4 per cent in 1988.

Retail sales growth will moderate in line with slower growth in real consumption. Current dollar retail sales are expected to increase by 7.8 per cent in 1988, following an estimated 9.7 per cent gain in 1987.

Housing Investment

Residential investment is expected to continue at a high level in 1988. However, housing starts will be sharply down from 97,000 to 73,000.

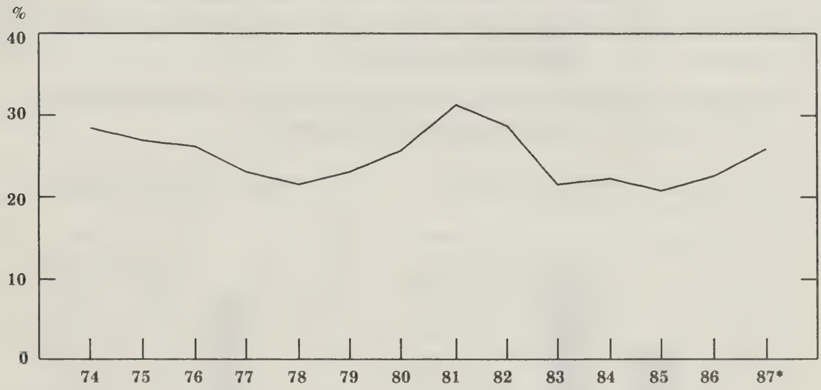
Ontario has experienced two years of very strong growth with residential investment expenditures increasing by 33.5 per cent in 1986 and by an estimated 29.7 per cent in 1987. Residential investment spending is forecast to rise by 9.7 per cent in 1988 as housing starts decline to a more sustainable

level. Renovation activity will account for an increasing proportion of investment in residential construction as households increasingly upgrade their housing stock.

A sharp rise in housing prices over the last two years and the attendant deterioration in affordability are typical of the later phase of a housing boom. Similar developments occurred near the end of the 1974 and 1981 construction booms.

- Average resale housing prices in Ontario increased by 25 per cent in 1986 and by an additional 24 per cent over the first three quarters of 1987.
- Housing affordability has deteriorated and will dampen demand. A common barometer of affordability is the ratio of mortgage payments on newly acquired homes to gross family income. A steady rise in this ratio during the previous two housing booms contributed to an eventual slowdown in housing activity. During the current boom, carrying costs as a percentage of gross family income have risen substantially, from 20.6 per cent in 1985 to an estimated 25.9 per cent in 1987.

ONTARIO MORTGAGE PAYMENTS AS A PER CENT OF FAMILY INCOME



* Estimate
Note: Mortgages on newly acquired homes.
Source: Canadian Real Estate Association, Statistics Canada and the Bank of Canada.

- A steep rise in down payments has also contributed to a deterioration in housing affordability. Assuming a standard down payment of 25 per cent, the minimum outlay for purchasing a home in Ontario has risen from 51.6 per cent of average family income in 1985 to an estimated 69.7 per cent in 1987.

Business Investment

Business investment in plant and equipment has been very strong in Ontario in 1987. Further gains are expected in 1988, although at a slower rate. These expected gains are the result of strong corporate profits, high rates of capacity utilization and continued sales growth.

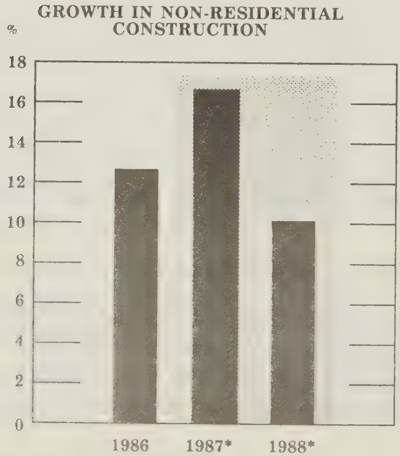
Ontario's corporate profits are expected to grow by almost 17 per cent in 1987 and 12.4 per cent in 1988. Robust growth in the Canadian economy, strengthening commodity prices and continued cost-cutting measures have all been contributing factors.

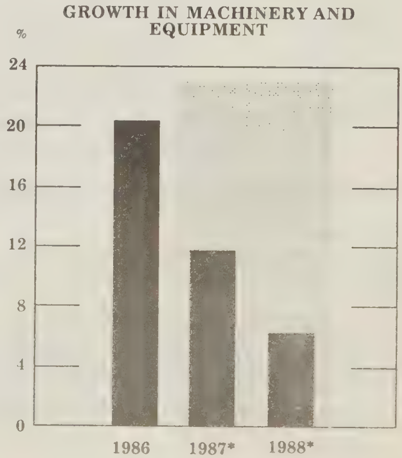
Steady increases in industrial production have boosted capacity utilization rates, which have risen substantially since the recession of 1981-82. Further increases in sales will spur more investment as businesses try to avoid production bottlenecks.

- The overall capacity utilization rate for total non-farm goods-producing industries has climbed from a low of 69.5 per cent in the last quarter of 1982 to 86.6 per cent in the second quarter of this year.
- Such diverse manufacturers as the textile, paper, furniture, and non-metallic mineral industries are experiencing capacity utilization rates in excess of 90 per cent.

Total business investment is forecast to increase from $25.9 billion in 1987 to $27.9 billion in 1988.

- Non-residential construction is expected to grow by 10.2 per cent in 1988, following a 16.7 per cent increase in 1987.
- Machinery and equipment spending will rise by 6.3 per cent in 1988, after an 11.8 per cent increase this year.
- Investment spending will be strongest in the retail and wholesale trade and commercial services sectors of the economy.





* Forecast
Source: Ontario Ministry of Treasury and Economics.

External Trade

In 1987, the trade sector has been a major source of weakness in the economy, partially offsetting the strength in domestic demand. While imports have been maintained by strong consumer and business spending,

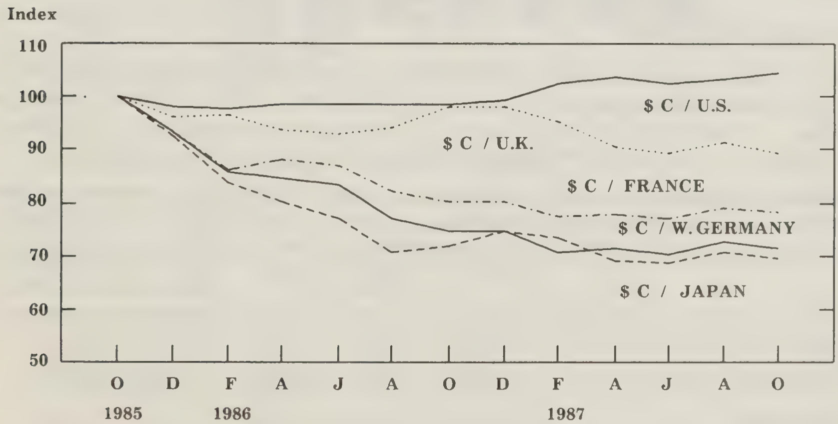
export growth weakened noticeably as a result of falling auto exports. The decline in auto exports reflects a sluggish U.S. auto market and lengthy shutdowns in some Ontario auto plants for conversion to new models.

- In nominal terms, exports are estimated to grow by less than one per cent this year, down sharply from 5.4 per cent last year.
- Over the first eight months of the year, auto exports were down 7.8 per cent from last year's pace. Total merchandise exports to the U.S. have declined by 5.2 per cent over the same period.
- Merchandise exports to other countries have risen by 12.5 per cent over the first eight months of the year.
- Imports are estimated to have grown by 2.1 per cent in 1987, compared to growth of 7.8 per cent last year.

Exports to the United States will rise in 1988, although the increase will be limited by weak growth in that country's economy. The depreciation of the Canadian dollar against most major world currencies will have a favourable effect on trade with other countries. Recent improvements in economic performance in Western Canada and the Atlantic provinces will provide a stimulus to Ontario's interprovincial exports.

- Since September 1985, the Canadian dollar has depreciated by 36.4 per cent against the yen, 33.5 per cent against the mark, 27.1 per cent against the franc, and 14 per cent against the pound.

CANADIAN DOLLAR EXCHANGE RATES OF MAJOR CURRENCIES
OCTOBER 1985 = 100



Source: Bank of Canada.

Ontario's overall trade balance, including international and interprovincial trade, is expected to improve slightly in 1988 as nominal exports and imports grow at about the same pace.

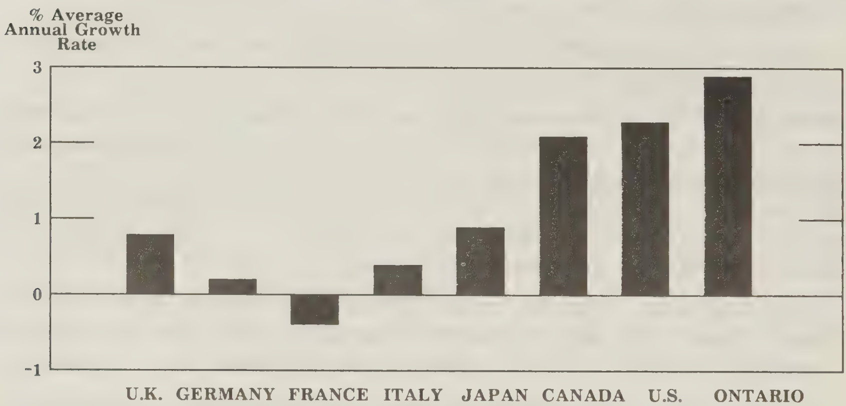
- Exports will increase by $5.1 billion to $110.7 billion in 1988.
- Imports are forecast to reach $100.5 billion in 1988, up $4.6 billion from the level in 1987.

Labour Markets

Introduction

From 1982 to 1987, Ontario's employment grew by over 630,000 people – an average annual growth rate of almost three per cent. This was a higher rate of growth than was achieved by any of the seven major industrial countries in the world.

INTERNATIONAL COMPARISON OF EMPLOYMENT GROWTH
1982 - 1987



Source: O.E.C.D. and Statistics Canada.

Forecast Overview

The Ontario labour market is expected to continue to improve next year. Employment is forecast to increase by 105,000. This is down from an average of 146,000 new jobs this year. The unemployment rate is expected to average 5.8 per cent in 1988, down from a 6.2 per cent average in 1987.

Ontario Labour Market Outlook — **Table 1**

	1986	1987 (000s)	1988	86/85	87/86 (percentage growth)	88/87
Labour Force	4,897	5,011	5,104	2.3	2.3	1.9
Employment	4,555	4,701	4,806	3.5	3.2	2.2
Job Creation	153	146	105	–	–	–
Unemployment	342	310	298	–	–	–
Unemployment Rate (%)	7.0	6.2	5.8	–	–	–
Participation Rate (%)	68.5	68.8	69.1	–	–	–

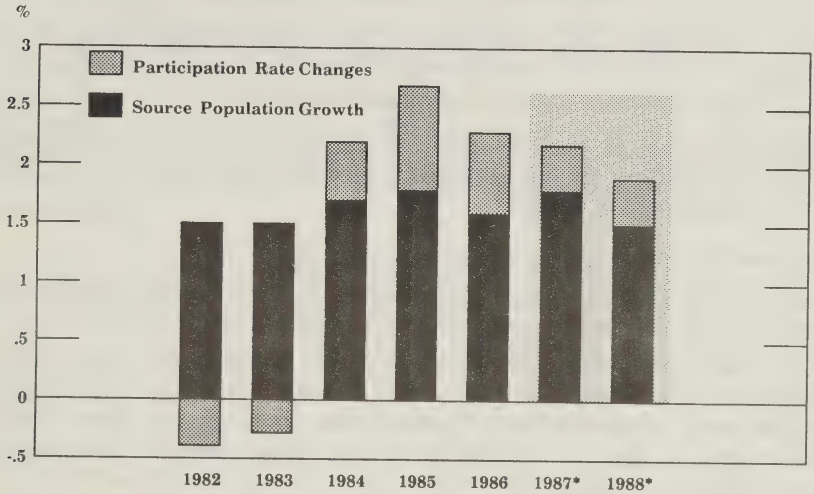
Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

Labour Supply

Ontario's labour force will increase by 2.3 per cent this year and is forecast to slow to 1.9 per cent growth in 1988. Source population growth accounts for 80 per cent of the increase with participation rate increases accounting for the remainder.

After reaching about 40,000 in 1986, net interprovincial migration is expected to moderate as growth in the Canadian economy becomes more regionally balanced. International migration, however, is expected to be higher than in the past few years. Overall, net migration to Ontario should add over 30,000 persons to the Ontario labour force in 1988.

ONTARIO LABOUR FORCE GROWTH

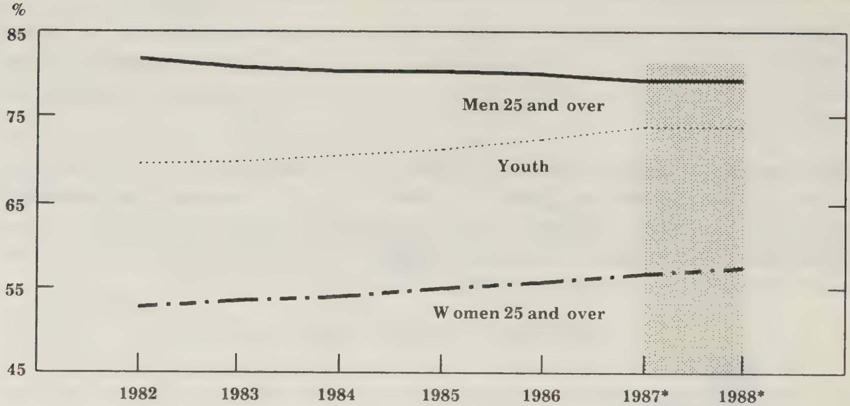


*** Forecast**
Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

Ontario's aggregate participation rate has risen continuously since 1983. The rise is accounted for by large increases in the participation of young people and adult women, partially offset by a decline in the participation of adult men.

- Youth labour force participation rates increased by more than four percentage points between 1982 and 1987. The gain was almost entirely the result of increased part-time participation by full-time students.
- The participation rate of women aged 25 and over rose from 52.6 per cent in 1982 to over 56 per cent in 1987. Women with children less than six years of age accounted for most of the increase.
- The participation rate of adult men dropped about two percentage points between 1982 and 1987 due to a decline in older workers' labour force participation. The participation rate of men aged 55 to 64 fell from 78.6 per cent in 1982 to about 70 per cent in 1987.

ONTARIO PARTICIPATION RATES



* Forecast
Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

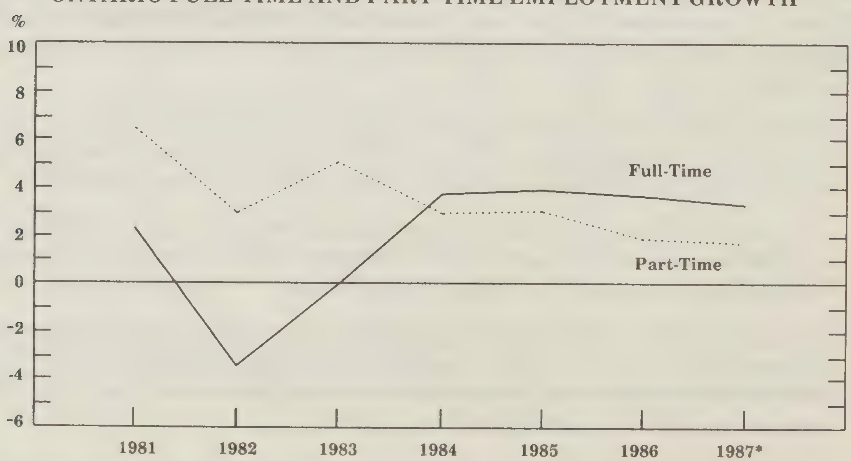
These trends are expected to continue through 1988. As a result, women's share of the labour force is expected to rise to about 45 per cent in 1988, up from 41.8 per cent in 1980.

Labour Demand

Employment growth is expected to slow from 3.2 per cent in 1987 to 2.2 per cent in 1988. Job creation will moderate from 146,000 to 105,000.

Part-time employment in Ontario grew much faster than full-time employment during the recession. However, since 1984 full-time employment has grown faster than part-time employment. Since 1982, over 80 per cent of the jobs created in Ontario have been full time, mostly in managerial and professional occupations. Of the 139,000 new jobs created in the first ten months of this year, 78,000 were managerial and professional positions and 38,000 were service, sales and clerical positions.

ONTARIO FULL-TIME AND PART-TIME EMPLOYMENT GROWTH



* Includes January to October 1987 only.
Source: Statistics Canada.

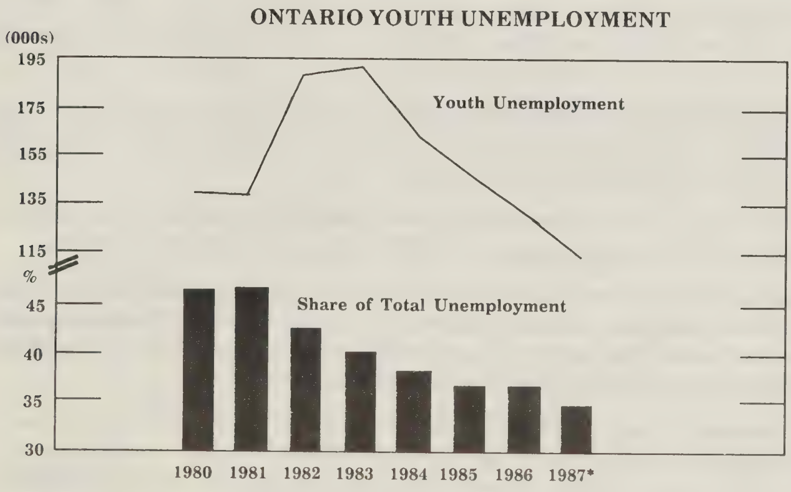
Full-time employment will continue to grow at a faster pace than part-time employment in 1988. Part-time work is expected to account for about 15 per cent of employment in 1988.

The private sector, which created over 85 per cent of the new jobs between 1982 and 1987, will continue to dominate job creation in 1988. Within the private sector, the rapid growth in self-employment peaked in 1985; self-employment in 1985 was 13 per cent of total employment. Since 1985, this growth has slowed and is expected to remain moderate in 1988.

Unemployment

The unemployment rate is forecast to average 5.8 per cent in 1988. This would be the lowest rate since 1974.

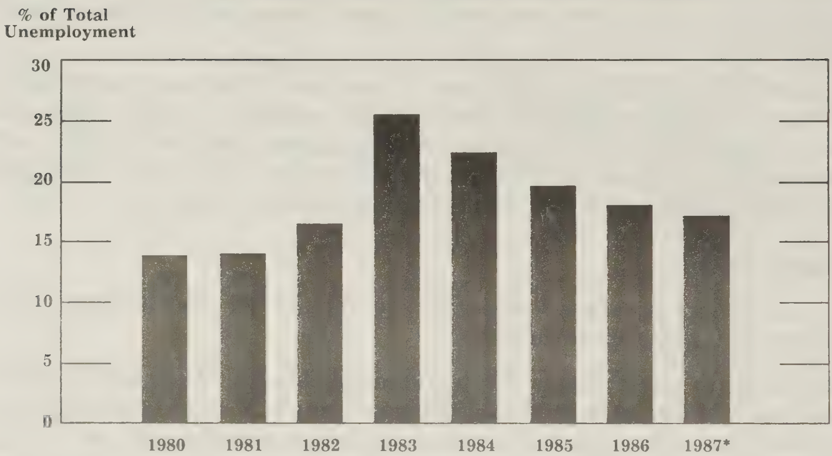
Ontario's youth unemployment rate averaged close to 10 per cent in 1987, down from 17.8 per cent in 1983. The youth share of total unemployment has fallen from a peak of 46.8 per cent in 1981 to less than 35 per cent in 1987. This largely reflects the decrease in the youth population. There has also been a significant narrowing in the traditional gap between youth and adult unemployment rates. Youth unemployment is forecast to decline further in 1988.



* Includes January to October 1987 only.
Source: Statistics Canada.

In spite of the overall strength of Ontario's labour market, the number of long–term unemployed is still significantly higher than at the beginning of the decade. In the first ten months of 1987, workers who were unemployed for more than six months represented 17.2 per cent of total unemployment, compared to 13.8 per cent in 1980.

ONTARIO LONG-TERM UNEMPLOYMENT



* Includes January to October 1987 only.
Source: Statistics Canada.

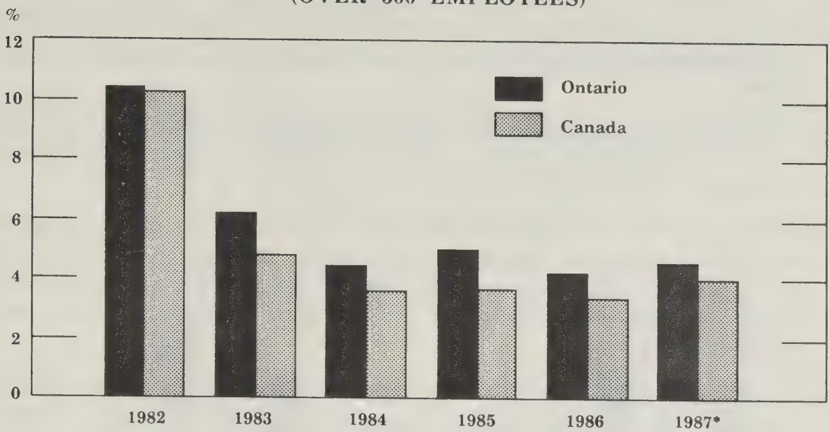
Wage Settlements

Real earnings per worker are expected to show little growth in 1988. This is despite tighter labour markets, particularly in the Metropolitan Toronto area.

Through the first three quarters of 1987, Ontario wage settlements, while above 1986 levels, have remained moderate. Ontario settlements still exceed settlements at the national level.

- In Ontario, collective bargaining settlements averaged 4.3 per cent in 1986. In the first three quarters of 1987, they averaged 4.6 per cent.
- Wage gains for Canada have been lower than wage gains in Ontario due to Ontario's tighter labour markets. Settlements in 1986 averaged 3.4 per cent across Canada. In the first three quarters of 1987, Canadian settlements increased by an average of four per cent.
- Private sector wage settlements have generally been below public sector settlements. In the first three quarters of 1987, Canadian settlements in the private and public sectors averaged 3.4 per cent and 4.1 per cent, respectively. In Ontario, settlements averaged 4.3 per cent for the private sector and 4.8 per cent for the public sector during the same period.

WAGE SETTLEMENTS
(OVER 500 EMPLOYEES)



* Includes January to September only.
Source: Labour Canada.

Ontario wage settlements are expected to increase roughly in line with inflation next year.

Non-Wage Compensation

Non-wage compensation is an increasingly significant component of total compensation. Included in non-wage compensation are wage-related costs such as holidays, vacations and paid leave, as well as costs associated with health, pension, and other benefits. Mandatory employer payments for unemployment insurance premiums, CPP contributions, and workers' compensation are also important labour cost items.

Although total non-wage compensation is difficult to measure, the evidence suggests that it is growing faster than total labour income. For example, mandatory employer payments, contributions to private pensions, and health benefits have risen steadily as a proportion of labour income in Ontario. They reached 9.5 per cent in the first half of 1987 compared to 8.6 per cent in 1982. This trend is expected to continue.

Inflation

Canada

The past year has seen a gradual increase in inflation. Consumer price inflation in Canada was running at 4.4 per cent for the first ten months of 1987, up from the 1986 average of 4.1 per cent. Canada's consumer price inflation is expected to rise by 4.6 per cent in 1988, up from 4.4 per cent this year.

Several factors will lead to slightly higher inflation next year.

- Higher U.S. inflation and the depreciation of the Canadian dollar against most major overseas currencies will put upward pressure on import prices.
- Oil prices have stabilized after a sharp decline in 1986 and will no longer have a deflationary impact. The price of oil delivered to Ontario is expected to remain around $19.00 U.S. per barrel.
- Other raw material prices are rising. Non-ferrous metal prices have risen by 9.9 per cent in the ten-month period ending in October 1987, while wood product prices were up 10.6 per cent. Further commodity price increases are expected as industrial demand continues to reduce world inventories.
- The broadening of the current expansion to the more resource-dependent provinces is resulting in tighter national labour markets. This will contribute to higher wage gains.
- Rate changes and base broadening of federal sales taxes scheduled to take effect on January 1, 1988 will put upward pressure on the Canadian CPI inflation rate.

The gap between the Canada and U.S. CPI inflation rates has narrowed steadily over the course of the year. In October, Canada's CPI inflation fell below the U.S. rate for the first time since December 1984. Canada's inflation rate is expected to be marginally higher than the U.S. rate in 1988.

Ontario

Since 1983, Ontario's consumer price inflation has been above the national rate. This trend has continued over the first ten months of this year, largely as a result of more rapid increases in housing prices. Ontario consumer price inflation is expected to average 5.1 per cent this year.

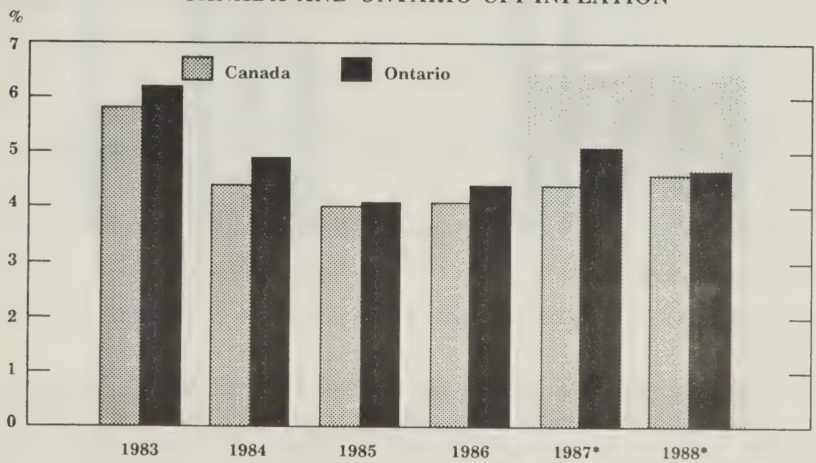
As house price increases moderate next year, Ontario's consumer price inflation will closely track the national rate. Ontario consumer prices are expected to increase by 4.7 per cent in 1988.

- Driven by a sharp rise in the cost of owner accommodation, the housing component of Ontario consumer prices rose by 5.6 per cent over the first ten months of the year, compared to a 3.9 per cent increase in Canada. The rise in housing costs accounted for 42 per cent of the overall increase in Ontario consumer price inflation and 89 per cent of the difference with Canada.
- Tighter labour markets have contributed to higher wage gains in Ontario relative to Canada.

Within Ontario, there is a considerable divergence in inflation between different cities. Inflation has been highest in Toronto, largely as a result of more rapid increases in house prices.

- The Toronto Consumer Price Index rose by 5.8 per cent over the first ten months of 1987. The housing price index rose by 7.1 per cent and accounted for 47 per cent of the increase in the Toronto Consumer Price Index. The stock market crash may have a dampening effect in 1988.
- Ottawa and Thunder Bay had much lower rates of overall inflation, at 4.0 and 3.2 per cent respectively. The housing component rose by only 3.0 per cent in Ottawa and by 1.5 per cent in Thunder Bay.

CANADA AND ONTARIO CPI INFLATION



* **Forecast**
Source: Statistics Canada and the Ontario Ministry of Treasury and Economics.

Medium-Term Outlook and Issues: 1989-1991

The medium-term outlook provides a projection of the performance of the Ontario economy during the 1989-1991 period. It is important to note that these projections do not necessarily imply targets for the economy; nor are they to be regarded as necessarily an acceptable economic performance.

Forecast Overview

There are several key assumptions that underlie the base case projection.

- The U.S. slows significantly in 1989, but not sufficiently to push the Canadian economy into recession.
- Steady improvement in the U.S. budgetary and trade deficits, coupled with stimulative policies in West Germany and Japan, sustain the global expansion.
- Wage and price inflation is contained to around five per cent.
- Energy prices increase in line with general inflation.
- The Canadian dollar remains below 80 cents U.S. over the forecast period.

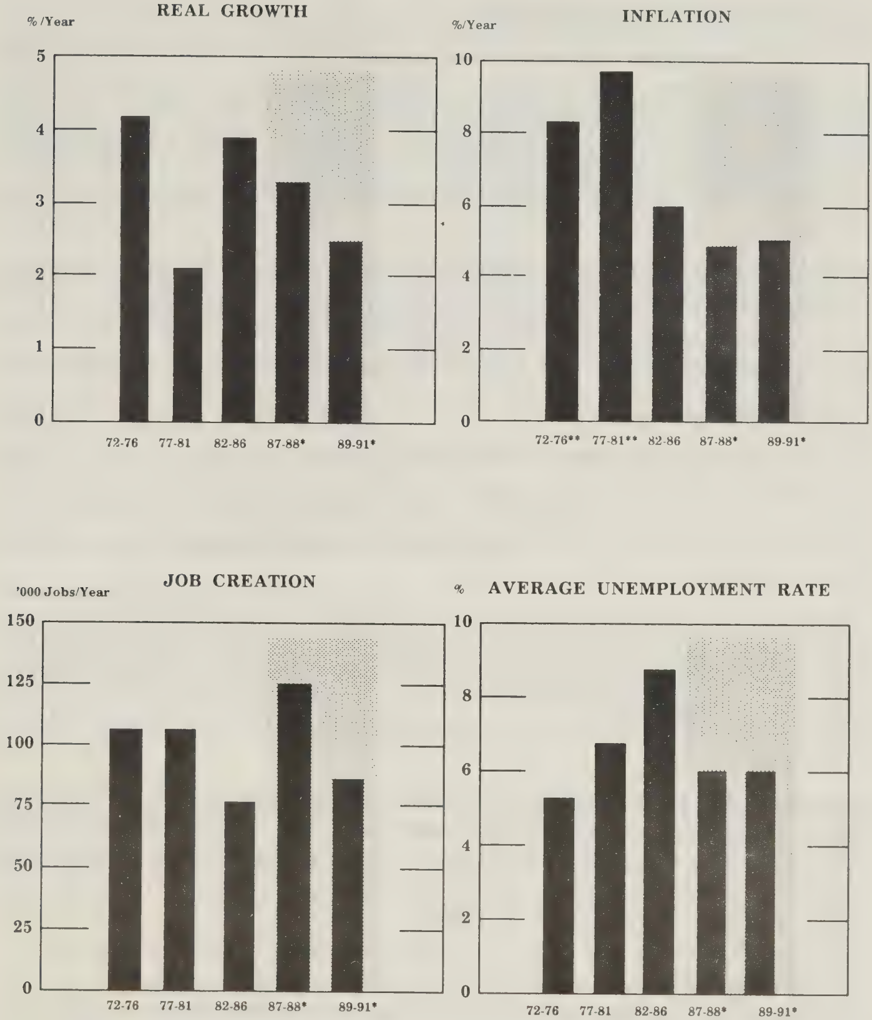
The following table summarizes the forecast for 1989-1991. The forecast is for continued, but slower growth over the period. Economic growth is weak in 1989, followed by stronger growth in subsequent years. The average is 2.5 per cent per annum for the period. The accompanying graphs compare this forecast performance with preceding periods.

The Ontario Economy: 1989-1991 (Annual Average) — **Table 2**

	Base Case
Real Growth (%)	2.5
Inflation (%)	5.0
Job Creation (000s)	87
Unemployment Rate in 1991 (%)	5.6

Source: Ontario Ministry of Treasury and Economics.

ONTARIO'S MEDIUM-TERM OUTLOOK



* Forecast

** Canadian inflation as pre-1980 data for Ontario are not available.

Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

Key Factors

U.S. Economy and World Economy

Over the forecast period, the U.S. is projected to achieve moderate growth averaging 1.9 per cent annually. Joint efforts by Congress and the Administration to reduce the federal budget deficit cause the U.S. economic expansion to slow sharply in 1989. The economy recovers in subsequent years. The large depreciation of the U.S. dollar since 1985 sets the stage for a gradual improvement in the trade balance that is sustained throughout the forecast period.

Modestly stimulative fiscal action is taken in Western Europe and Japan. This partially compensates for fiscal restraint in the United States. As well, a favourable Canadian dollar exchange rate in overseas currencies provides export opportunities in other foreign markets as well as in the U.S. market.

Canadian Economy

The Canadian economy will continue to expand over the medium term, growing at a 2.4 per cent average annual rate over the period. Steady, but modest, increases in commodity prices will benefit the resource-based economies of Western and Eastern Canada, resulting in more regionally balanced growth.

The forecast assumes implementation of stage I of tax reform. The planned reform of the tax system will have a modest stimulative impact on economic growth, mainly through the effect of lower personal income taxes on personal consumption.

Financial Markets

Interest rates peak in 1989 as inflation drifts up over five per cent. A moderating inflation rate permits some softening in interest rates in 1990 and 1991. The Canadian dollar benefits from an improvement in Canada's terms of trade and from wide Canada-U.S. interest rate spreads, appreciating to 79 cents U.S. by 1991.

Oil Prices

Oil prices are expected to be relatively stable in real terms over the medium term, despite the pressure of considerable uncertainties within OPEC. This will provide a positive climate for investment in petroleum exploration and development. As a result, the economies of the oil and gas producing provinces will benefit, as will Ontario's energy-supplier industries.

Sources of Growth

Business spending and exports are expected to play a leading role in economic growth over the medium term, supplanting the role of housing and consumer spending in recent years. Investment spending will be sustained by continued growth in final sales, high rates of capacity utilization and healthy gains in corporate profits.

Over the earlier phase of the current expansion, a rapid decline in the savings rate permitted real consumption to grow at a significantly quicker pace than real disposable income. The attendant run-up in consumer debt, coupled with higher interest rates over the forecast period, will reverse this trend.

Over the medium term, real consumer spending growth will lag behind income gains as the savings rate inches up from its 1987 trough. Tax reform will provide a temporary stimulus to consumer spending in 1989. However, the impact of a higher savings rate will limit growth in consumer spending in 1990 and 1991.

Slower household formation and the increased price of housing will dampen housing demand relative to the 1986-1987 boom. Housing starts are projected to average 70,000-75,000 units per year.

The trade sector will recover after 1989, with net exports playing a larger role in economic growth in 1990 and 1991. Export gains will be limited in 1989 by a weaker U.S. economy, but will pick up in the following years. Import growth will slow through the medium term, in line with more moderate gains in domestic demand.

Employment, Productivity and Inflation

Employment and Labour Force

The Ontario economy is projected to generate 87,000 jobs per year over the 1989-1991 period. Employment is expected to grow at an average annual rate of 1.8 per cent. The labour force is expected to grow at a 1.7 per cent average annual rate. The unemployment rate declines gradually to 5.6 per cent in 1991.

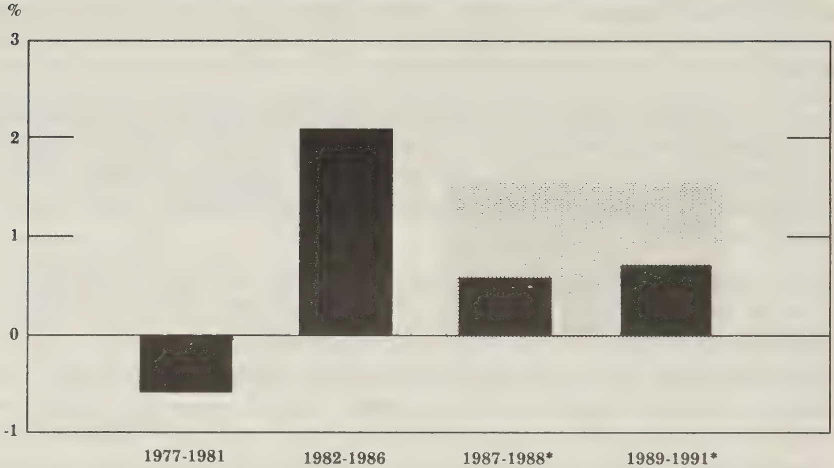
Growth of the labour force will slow over the forecast period. This reflects a slowdown in the growth of the over–15 population, only partially offset by a higher participation rate.

Productivity

Productivity growth is a crucial factor for the province's medium-term economic prospects, affecting international competitiveness, job creation and real income growth. Productivity is expected to grow at close to its current rate, following very rapid growth during the early phase of this cyclical recovery. The projected 0.7 per cent average annual increase in output per employee over the medium term compares very favourably with performance during the late 1970s. Relatively strong productivity growth over this period will be supported by:

- stable real energy prices;
- moderate inflation;
- recent strong capital formation; and
- maturing of the labour force.

ONTARIO PRODUCTIVITY PERFORMANCE
(Compound Annual Growth Rates)



*** Forecast**
Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

Inflation

Consumer price inflation is expected to average five per cent over the 1989-1991 period. Inflation peaks in 1989, partly in response to stage one increases in the federal sales tax. Following slower growth in 1989, inflation moderates in 1990 and 1991.

Alternative Scenario: Impact of a 1989 U.S. Recession

All forecasts are contingent on certain assumptions. Because Ontario has an open economy highly dependent on trade, the key assumptions for Ontario concern external factors. The base case, outlined earlier, presumes a generally supportive international economic environment, particularly with respect to the U.S. economy. This section provides an alternative medium-term projection of the Ontario economy based on a less favourable assumption about the performance of the U.S. economy.

In this scenario, U.S. domestic consumption continues to grow strongly in 1988. As a result, the U.S. trade deficit shows no improvement, leading to continued depreciation in the U.S. dollar. The falling dollar discourages foreign capital flows needed to finance U.S. trade and budget deficits. The dollar decline also adds renewed inflation concerns. The Federal Reserve Board tightens monetary policy. In 1989, fiscal policy turns restrictive in order to reduce the budget deficit. These restrictive policies lead the U.S. economy into a recession in 1989.

In this scenario, the downturn in the U.S. economy leads to no growth in the Ontario economy in 1989. Initially, the impact of a U.S. recession is felt in Ontario export sectors such as autos, resource-based commodities and

capital goods oriented to U.S. markets. Lower employment and income in the export sectors in turn weaken domestic demand.

The Ontario economy recovers in 1990, in step with a rebound in the U.S. economy. The expansion of real output and employment continues in 1991.

The 1989-1991 Ontario Economy: Alternative Scenario **Table 3**
(Annual averages)

	Base Case	Recession Case
Real Growth (%)	2.5	1.9
Inflation (%)	5.0	4.2
Job Creation (000s)	87	78
Unemployment Rate in 1991 (%)	5.6	6.0

Source: Ontario Ministry of Treasury and Economics

- Job creation falls sharply in 1989 before recovering to average 100,000 over 1990 and 1991. It averages 78,000 over the period.
- The unemployment rate rises by almost a percentage point to 6.7 per cent in 1989. The impact of weaker job creation on the unemployment rate is partially offset by slower labour force growth. A recovery in employment growth pushes the unemployment rate down to six per cent by 1991.
- Slower economic growth and higher unemployment contribute to lower inflation than in the base case. Over the 1989-1991 period, Ontario consumer prices rise at an average 4.2 per cent annual rate.

Tax Reform: Stage I

The medium-term forecast incorporates the economic impact of the first stage of tax reform announced by the federal government last June. These measures will reduce personal income tax revenues. These losses are offset by raising corporate income tax revenue and increasing federal sales tax revenues through broadening the tax base. Corporate tax rates will be reduced but the base will be broadened by a number of measures, including curtailed capital cost allowances.

The net effect of stage one of tax reform on the Ontario economy will be marginally positive. By 1991, real output is 0.3 per cent higher than would have occurred without tax reform. Consumer spending is stimulated by higher disposable income growth. Business investment spending is lower, due mainly to reduced depreciation allowances. Various sales tax increases will put upward pressure on consumer prices in the short-run, but this effect gradually diminishes.

- The simulation results in Table 4 reflect the assumption that the final reform package is as announced by the Minister of Finance in June, 1987. In this regard, Ontario has suggested changes in the proposed reforms of, amongst other things, the capital cost allowance, put-in-use

rules for capital investment and the incentives for research and development spending by some corporations.

Economic Impact on Ontario of Tax Reform, Stage One **Table 4**
(Per cent change from no Tax Reform Case)

	1988	1989	1990	1991
Real Output	0.0	0.2	0.3	0.3
Consumption	0.1	0.9	1.3	1.2
Business Investment	-0.4	-0.8	-1.0	-1.3
CPI Inflation Rate*	0.3	0.2	0.1	0.0

Source: Ontario Ministry of Treasury and Economics.
* Change in percentage points

The medium-term outlook does not incorporate the proposed second stage of tax reform which may introduce a new broadly-based national sales tax. The design and timing of changes in the second stage are yet to be determined.

Canada-U.S. Trade and Investment Agreement

A single quantitative estimate of the macroeconomic impact of the proposed Canada-U.S. trade and investment agreement is not possible. The proposed deal covers many areas and issues – for example, from tariffs to investment, to energy, to services, to procurement, to agriculture, and to dispute settlement. Most, if not all, do not lend themselves to summary arithmetic evaluations. There are issues of the balance of Canadian versus U.S. gains in the deal. Many argue that Canada has made fewer gains, and conversely faces higher costs, in the overall package of proposals. As well, in areas such as energy pricing, quantitative restrictions on exports and foreign investments, there are issues related to future flexibility to pursue regional and industrial development.

Therefore, this section is not an overall assessment of the costs or the benefits of the proposed deal. Nor does this section review the pros and cons of each element of the package. Such an analysis would be much longer than can be offered here.

This section does, however, make general references to the impacts of mutual Canada-U.S. tariff reductions and to the failure to enhance materially Canada's "security of access" to the U.S. market.

If passed into law, tariff reductions under the proposed Canada-U.S. trade agreement only begin, on a phased basis, in 1989. The relatively low average level of existing Canada-U.S. tariffs, the relatively modest amount of Canada-U.S. trade affected by tariffs, and the 10-year phased-in nature of the changes, imply that the overall impact in the forecast period to 1991 is likely to be very small in relation to the prospective growth of the economy.

The reduction of Canadian tariffs will cause dislocation in some industries, for example food processing and household appliances. Nonetheless,

marginally lower prices for imported goods should lower consumer prices and modestly increase real incomes in Canada. The effect of this is to boost aggregate demand and stimulate industry in general. Phasing out U.S. tariffs on Canadian exports may provide a slight competitive boost to some Canadian industries in U.S. markets. The net effects of mutual tariff reduction will be very small, but marginally positive. This is not to imply, however, that the tariff reduction deal on its own merits was a favourable negotiation for Canada, given the relatively higher starting point for Canadian tariffs. Any adjustment costs can be expected to be much larger, both absolutely and relatively, in Canada than in the United States. This issue has not been addressed in the principles of the proposed deal.

Any potential benefits of the overall deal would have been larger had the proposed agreement contained mechanisms which gave greater assurance against U.S. harassment of Canadian exports under the U.S. contingent protection laws. This would have given more "secure access". Also, had the proposed agreement removed the export tax on softwood lumber and provided access to U.S. defence procurement, and to state and local government procurement, economic gains would have been larger. In this case Ontario and the rest of Canada could have anticipated some increases in investment spending. Productivity growth would have been higher over the medium term. Export earnings would have increased, permitting either a stronger Canadian dollar and/or lower Canadian interest rates.

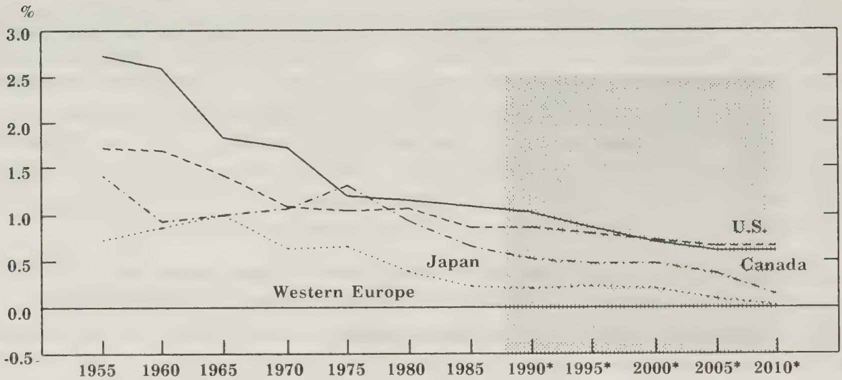
Population Growth

Population growth and age structure have a strong influence on economic growth through their impact on labour supply, labour quality and savings rates. They also have an influence on the level and composition of domestic demand.

The Ontario population is currently projected to reach 9.7 million in 1991 and 10.7 million by 2006. The average annual rate of increase between 1986 and 1991 will be just over one per cent, comparable to the average rate in the first half of the 1980s. The relative contribution of natural increase rises over the period to 1991, but then falls off considerably through the 1990s.

Details of the projection were reported in the June 1987 Demographic Bulletin. Fertility rates are assumed to fluctuate in a narrow band around their current level; mortality rates are assumed to continue their slow, gradual decline; immigration is assumed to increase in line with federal policy targets; and recent gains from net interprovincial migration are assumed to taper off to average historic levels by the early 1990's, as more balanced economic growth is achieved among the regions of Canada.

POPULATION GROWTH, SELECTED COUNTRIES **



* Forecast

** Data points are average annual increases over five preceding years.

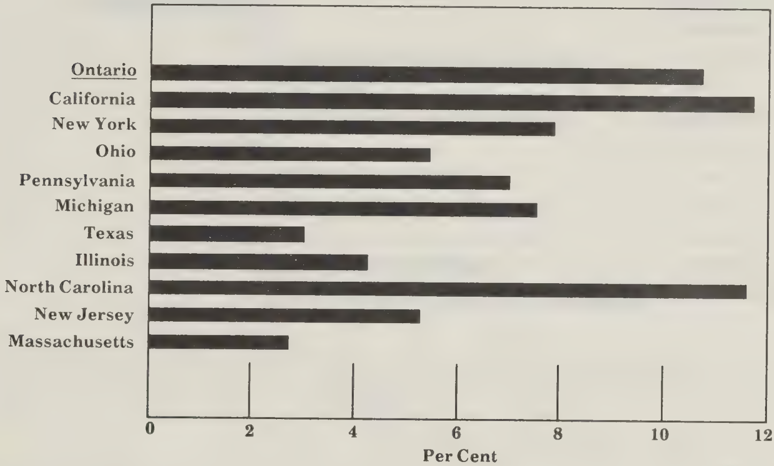
Source: UN World Population Prospects.

Over the next twenty years, Ontario's population growth will continue to outstrip that of most industrial countries, and of most provinces. European countries and Japan will approach zero population growth. Ontario's population is projected to grow at a 0.8 per cent average annual rate.

Large Industrial States: Comparative Performance

In recent years, Ontario has had one of the strongest economic performances among large industrial jurisdictions in North America. The largest industrial states in the United States are California, New York, Ohio, Pennsylvania, Michigan, Texas, Illinois, North Carolina, New Jersey and Massachusetts. In 1986 these ten states accounted for 55 per cent of U.S. manufacturing employment and 53 per cent of total employment.

EMPLOYMENT GROWTH 1984-1987*



*** Based on January to October employment.**
Source: Statistics Canada and D.R.I.

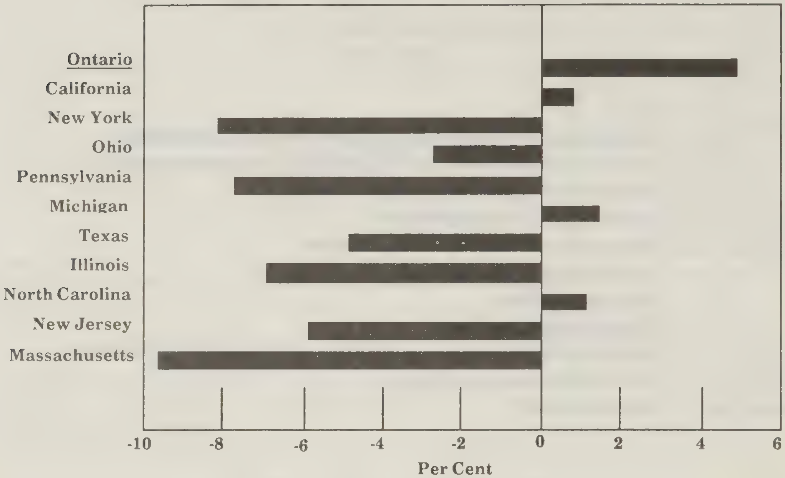
Total employment growth for the average of the ten largest U.S. industrial states from 1984 to 1987 (January-October) was 7.1 per cent. The comparable rate for Ontario was 10.8 per cent. On an individual basis, Ontario's total rate of job creation was surpassed by only two of the ten major industrial states.

- Employment rose by 11.7 per cent in California and 11.6 per cent in North Carolina over the same period.
- The employment level rose by only 3.0 per cent in Texas, reflecting the energy downturn. Massachusetts experienced only a 2.7 per cent gain in jobs, despite higher levels of defence spending and an expanding high technology base.

Manufacturing enterprises employ over one million Ontario residents. Over 90 per cent of Ontario's exports in 1986 were produced by manufacturing enterprises. Therefore, strong performance in this sector has a large impact on the general performance of the Ontario economy. Comparative data on manufacturing employment growth reveal a strong relative performance in Ontario. Ontario manufacturing employment growth has exceeded that of every major industrial state in the United States.

- Manufacturing employment in Ontario expanded by 4.9 per cent between 1984 and 1987 (January-September). Persons employed in manufacturing fell by an average 3.8 per cent in the ten largest U.S. industrial states over the same period, reflecting a net loss of 410,000 jobs.

MANUFACTURING EMPLOYMENT GROWTH*
1984-1987



* Based on January to September employment.
Source: Statistics Canada and D.R.I.

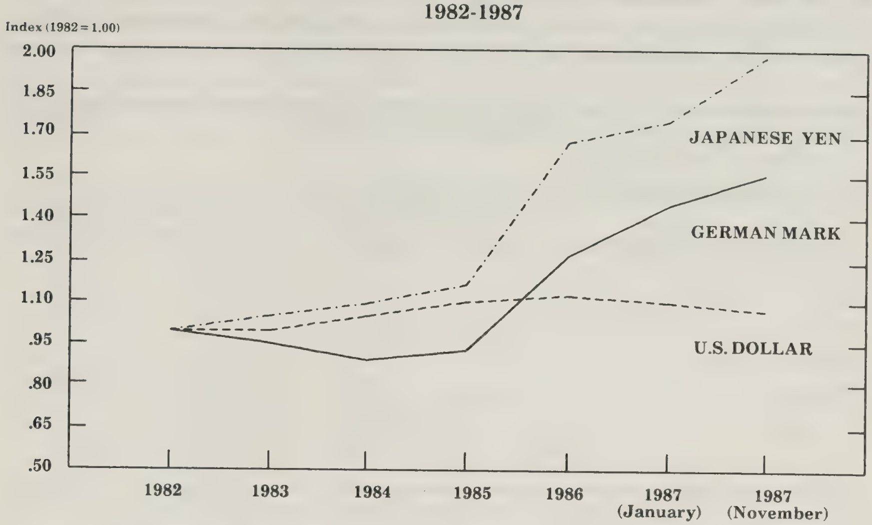
Manufacturing Investment Climate

International Competitiveness

Exchange rate fluctuations can exert a substantial effect on international competitiveness. The Japanese yen and the West German mark have each appreciated almost 80 per cent against the U.S. and Canadian dollars over the past three years. Currencies of other European countries have appreciated against the North American currencies as well, albeit at a somewhat slower pace.

This has resulted in improved competitiveness of Canadian manufacturing and dramatically reduced profitability of the Canadian and U.S. markets for Japanese and European exporters. Japanese exporters are reducing their emphasis on exports to North America, while intensifying their marketing efforts in Europe. At the same time, there is a growing trend for European and Japanese firms to shift towards direct investment in North America. In Ontario, direct investment has been particularly significant in the automotive assembly and parts industries.

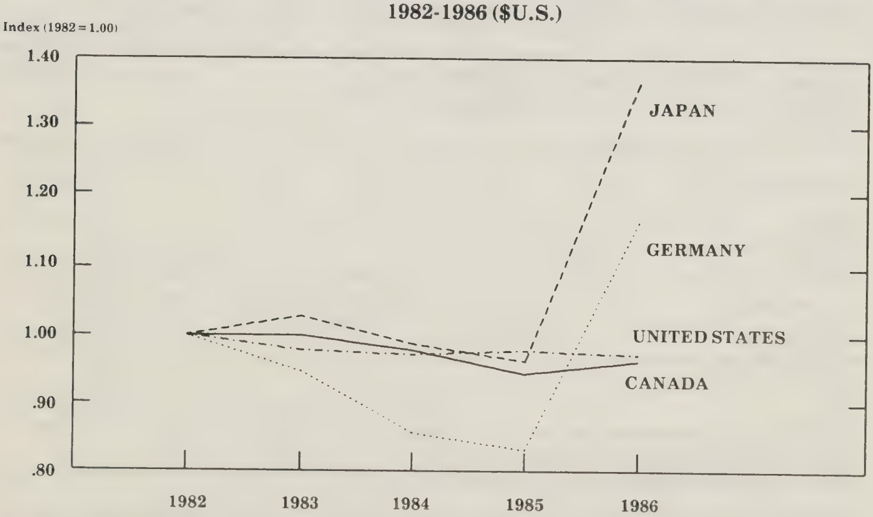
APPRECIATION OF SELECTED CURRENCIES vs. CANADIAN DOLLAR 1982-1987



Source: Bank of Canada and Bank of Montreal Treasury Group.

As the graph below suggests, these movements in exchange rates have resulted in sharp increases in Japanese and German unit labour costs in manufacturing relative to Canada and the United States.

MANUFACTURING UNIT LABOUR COSTS, SELECTED COUNTRIES 1982-1986 ($U.S.)



Source: United States Bureau of Labor Statistics.

Costs of production in Canadian manufacturing now compare favourably with both the United States and Japan in terms of total hourly compensation. This measure includes both money wages and fringe benefits. Recent data indicate that Canadian hourly compensation is distinctly lower in the transportation equipment, machinery, fabricated

metals and chemical industries, at prevailing exchange rates, than in both of the other countries. Indeed, for manufacturing industries as a whole, Canadian hourly labour compensation is roughly equivalent to that in Japan, and significantly lower than that in the U.S.

Hourly Compensation for Selected Industries, Canada, U.S. and Japan **Table 5**
(1986 Cdn. dollars, adjusted for Nov. 1987 exchange rates*)

Industry	Canada	U.S.	Japan
Transportation Equipment	18.18	24.35	19.67
Electrical Products	14.30	17.50	13.90
Textiles	11.56	11.63	11.19
Fabricated Metals	14.58	17.71	15.53
Machinery	15.89	18.98	17.88
Chemicals	16.18	21.86	24.66
Paper	19.96	20.26	16.48
Total Manufacturing	**15.35**	**17.43**	**15.65**

* Relevant exchange rates are:
$1 CDN = $0.758 U.S.
$1 CDN = 102 yen
Source: United States Bureau of Labor Statistics.

Ontario's improved competitiveness has led to increases in employment. As shown in Table 6, since the recession, growth in manufacturing employment in Ontario has been significant relative to that in other countries.

Change in Manufacturing Employment, Ontario and Selected Countries, 1986/1982 **Table 6**
(per cent)

ONTARIO	**7.5**
Japan	5.9
United States	2.1
Sweden	-1.9
W. Germany	-2.4
Norway	-4.6
United Kingdom	-9.8
Italy	-9.9
France	-10.2

Source: United States Bureau of Labor Statistics and Statistics Canada.

Ontario manufacturing shipments to the U.S. have increased sharply during the 1980s, while shipments to the rest of Canada have not grown in proportion. This orientation has been particularly noticeable for transportation equipment, electrical products, furniture and primary metal industries.

In large part, Ontario's increase in exports to the U.S. reflects exchange rate advantages and the upsurge in U.S. demand for autos built in Canada. As a result of the steady decline in the Canadian dollar to approximately U.S. $0.75, wage rates in Ontario are generally lower than those in immediately adjacent states in the U.S. (e.g. Michigan) and competitive with lower wage states such as Georgia. Ontario companies enjoy other competitive advantages, including lower health costs and lower energy costs.

Monthly Electricity Costs for Industry, 1987 — **Table 7**
(Canadian dollars)

California (Los Angeles)	32,652
New York (New York City)	44,500
Illinois (Chicago)	39,515
Massachusetts (Boston)	29,057
Ontario (City of Toronto)	20,850

Note: Relevant exchange rate is $1 CDN = $0.758 U.S.
Based on industrial user with 400,000 Kw.h. demand and 1,000 Kw peak load.
Source: Ontario Hydro.

Hourly Earnings for Selected Industries — **Table 8**
(1986 Cdn. dollars adjusted for 1987 exchange rates)

Industry	Ontario	United States: Michigan	United States: Georgia	United States: Total U.S.
Transportation Equipment	**14.30**	19.82	17.27	16.90
Electrical Products	**11.09**	14.18	14.27	12.73
Textiles	**10.45**	-	8.94	9.14
Fabricated Metals	**11.31**	16.66	11.75	13.05
Machinery	**12.31**	17.08	12.90	13.97
Chemicals	**12.61**	17.04	13.72	15.80
Total Manufacturing	**12.11**	**16.89**	**11.00**	**12.84**

Notes: Relevant exchange rate is $1 CDN = $0.758 U.S.
This table differs from Table 5 in that earnings include overtime but not fringe benefits.
Source: United States Bureau of Labor Statistics and Statistics Canada.

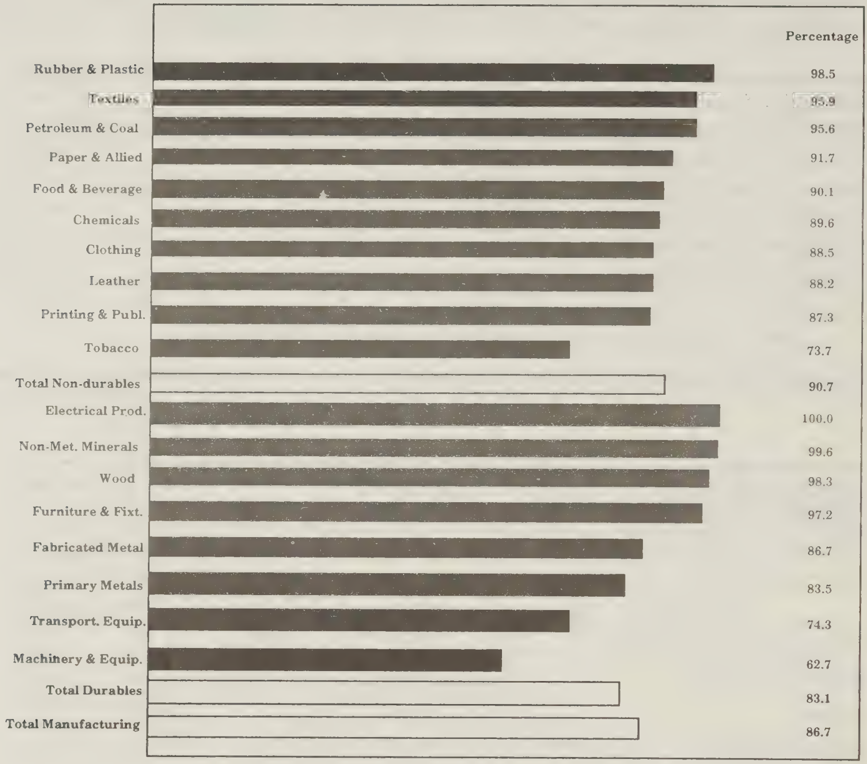
Manufacturing Capacity Utilization

Total manufacturing capacity utilization rose by one percentage point in the first quarter of 1987 to a rate of 86.8 per cent and continued at 86.7 per cent through the second quarter of this year. Non-durable goods industries displayed a higher overall utilization rate (90.7 per cent) than those producing durable goods (83.1 per cent).

Several industries are approaching capacity constraints. In particular, the electrical products, non-metallic minerals, rubber and plastic, wood, furniture, textiles and petroleum industries are all running at more than 95

per cent of capacity. In contrast, the machinery and transportation equipment industries are operating at relatively low (less than 75 per cent) levels of capacity.

CAPACITY UTILIZATION RATES IN CANADIAN MANUFACTURING, SECOND QUARTER 1987



Source: Bank of Canada

Manufacturing Investment Outlook

In recent years, manufacturing investment increases have been largely attributable to the auto and steel industries. In 1987, investment growth has been less dramatic, but more broadly based among industries. This reflects continued growth in consumer demand, high capacity utilization rates, profit growth and continued competitive pressures to improve productivity through purchases of new machinery and equipment.

For 1987, manufacturing sector investment should account for about one-third of Ontario's total business investment. Within manufacturing, the largest share of investment ($2.4 billion) took place in the transportation equipment industry followed by primary metals, food and beverages, chemicals and electrical products.

Industries with substantial increases over last year's investment levels include printing and publishing, wood, electrical products, paper and allied, and food and beverages. Declines occurred in the metal fabricating, textile and related, and primary metal industries.

Investment by Ontario Manufacturing Industries, 1986 and 1987 — **Table 9**

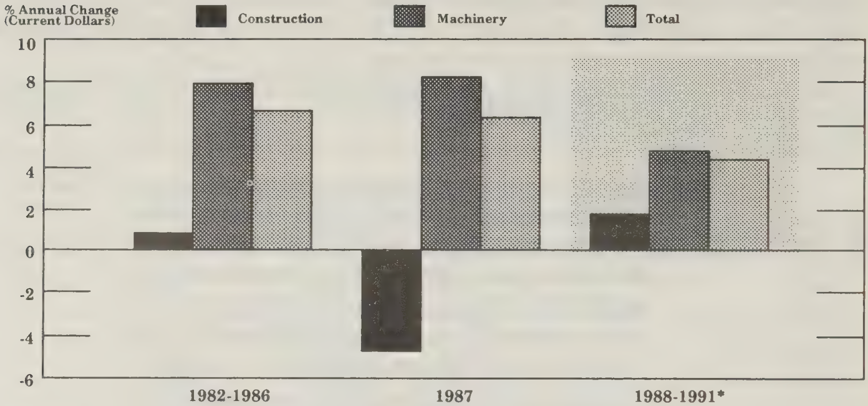
Industries	Actual 1986 $ Million	Intentions 1987 $ Million	1987 Share of Total %	1987/1986 Annual Change %
Resource-based Industries	**1,378.0**	**1,461.7**	**17.7**	**7.9**
Wood	57.5	81.7	1.0	42.1
Paper and Allied	331.6	415.5	5.0	25.3
Primary Metal	988.9	964.5	11.7	(2.5)
Transportation Equipment	**2,379.1**	**2,447.0**	**29.7**	**2.9**
Industrial Products	**2,145.7**	**2,178.6**	**26.4**	**8.5**
Metal Fabricating	572.3	348.1	4.2	(39.2)
Machinery	209.8	238.7	2.9	13.8
Rubber and Plastics	230.7	253.0	3.1	9.7
Electrical Products	353.3	488.0	5.9	38.1
Non-Metallic Minerals	182.1	200.3	2.4	10.0
Chemicals & Petroleum Refining	597.5	650.5	7.9	8.9
Consumer Products	**883.0**	**1,106.8**	**13.4**	**29.4**
Food, Beverages and Tobacco	516.1	644.9	7.8	25.0
Textiles and Related	201.1	197.6	2.4	(1.7)
Furniture and Fixtures	38.1	44.5	0.5	16.8
Printing and Publishing	127.7	219.8	2.7	72.1
Manufacturing Total*	**7,761.5**	**8,245.5**	**100.0**	**6.2**

* Includes miscellaneous manufacturing and capital items charged to operating expenses.
Source: Statistics Canada.

Following substantial average annual growth of 6.6 per cent over the period 1982 to 1986, and a further 6.2 per cent increase in 1987, it is anticipated that manufacturing investment will increase by some 4.3 per cent per year over the forecast period 1988 to 1991. This slowdown reflects the expected slower overall economic growth in Canada and the United States and the completion of major projects in both the auto and steel industries.

New capital investment by Ontario manufacturers will approach $10 billion by 1991. Competitive pressures to improve quality and reduce costs, as well as relatively stable interest rates, will help to encourage outlays for new equipment.

GROWTH IN ONTARIO MANUFACTURING INVESTMENT
1982-1991



* Forecast
Source: Ontario Ministry of Treasury and Economics

Sector Outlook

Overview

For the past five years, the economy has been expanding at a rapid rate, with growth concentrated in relatively few industries. Manufacturing growth averaged 4.4 per cent per year, with much of the impetus coming from extremely high growth in transportation equipment. Primary sector growth averaged 5.1 per cent, buoyed by rapid increases in gold mining.

The outlook for the 1988-1991 period is for continuing but more moderate expansion in both the primary and manufacturing sectors (see Table 10). Growth is expected to be broadly based across most industries, reflecting recent high levels of investment spending and costs that have become more internationally competitive due to recent exchange rate changes.

Primary and Manufacturing Sector Outlook for Ontario **Table 10**
($1981)

	1986		Real Output	
		Real Output	Annual % Change	
	Employment	$Million	1987	1988-91
Primary	159,437	6,050	6.0	1.9
Manufacturing	950,834	38,369	2.2	2.4

Source: Conference Board of Canada, Statistics Canada and Ontario Ministry of Treasury and Economics. Forecasts in this section are based on the "base case" medium-term outlook.

Primary Sector Outlook

Ontario agriculture, mining and forestry are experiencing large increases in real output this year. This strong performance is expected to be followed by moderate increases in the next four years.

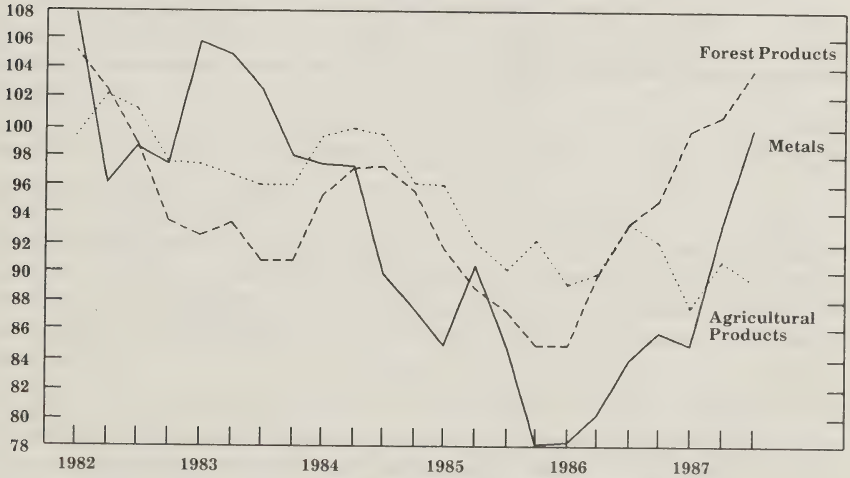
Primary Sector Outlook for Ontario **Table 11**
($1981)

	1986		Real Output Annual % Change	
	Employment	Real Output $Million	1987	1988-91
Primary	**159,437**	**6,050**	**6.0**	**1.9**
Agriculture	128,000	3,114	6.4	1.9
Mining	30,246	2,400	5.8	2.0
Forestry and Fishing	11,191	536	4.8	1.9

Source: Conference Board of Canada, Statistics Canada and Ontario Ministry of Treasury and Economics.

Real prices of Ontario's major resource commodities all declined during the early 1980s. The metals price index (nickel, gold, copper, and zinc) fell most sharply; but in 1986 metal prices began to strengthen dramatically. Similarly, the forest products price index (kraft pulp, newsprint, and lumber) began to recover strongly in 1986 and has now risen above its 1982 level. Agricultural prices have shown less resiliency. Grain prices, especially for corn, are worsening due to the U.S.-E.E.C. agricultural trade war and hog prices are experiencing a cyclical decline.

PRICES OF ONTARIO RESOURCE COMMODITIES
(1982 = 100)



Source: Ontario Ministry of Treasury and Economics.

Agriculture

Total production in Ontario agriculture is expected to grow at about six per cent this year reflecting both an excellent growing season and large buildups of cattle and hog inventories (not included in livestock receipts). Highlights include higher pork, poultry and beef production. Favourable growing conditions this year have increased 1987 output of most grains and oilseeds.

Over the period to 1991, total production will grow at a 1.9 per cent annual rate. Livestock marketings are expected to increase, particularly in 1988 and 1989. Contraction in corn production, due to falling prices, will offset expected increases in soybean production for which prices are expected to remain more stable. This will primarily affect Southwestern Ontario where most cash cropping takes place. Specialty crops are expected to show significant growth due to a shift in acreage from more traditional crops with poor prospects. Nursery crops will continue to benefit from the recent growth in Ontario housing. Little growth in overall fruit and vegetable production is expected due to stiff import competition. Prospects for tobacco production are poor beyond 1989 when the current three-year agreement on crop size ends.

Agricultural Outlook for Ontario — **Table 12**

	Annual % Change	
	1987	1988-91
Total Livestock (Real Receipts)	1.1	1.8
Total Crops (Real Receipts)	0.8	-0.3
Total Intermediate Inputs (Real Operating Costs)*	1.0	-1.1
Real Output **	6.4	1.9

* Includes expenses for machinery, fertilizer and lime, other crop and livestock inputs, repairs to buildings, gross farm rent and miscellaneous expenses.

** Change in real output reflects changes in real receipts less real operating costs, adjusted for changes in inventories, government deficiency payments and income in kind.

Source: Ontario Ministry of Treasury and Economics.

Mining

After several difficult years, conditions in the mining industry have shown dramatic improvement. Metal prices have strengthened substantially as worldwide supply and demand have come into better balance. Overall industry employment, after declining for many years, now appears to be stabilizing. Capital investment in 1987 is expected to exceed $731 million, a 16.6 per cent increase over last year. This includes $149 million in general exploration expenditures, a 35.6 per cent increase over 1986. Most of this investment is related to precious metals, although two significant base metal deposits are also under exploration and development.

Some two-thirds of Ontario's mineral production is accounted for by five metals: nickel, gold, copper, uranium and zinc. Demand for nickel, copper and zinc has firmed up considerably, and with Ontario's producers being among low to average cost producers, they should be able to maintain or expand production. Ontario gold production, after expanding nearly 50 per cent in 1986, is expected to show further but more modest increases over the forecast period. Most of Ontario's uranium production is under long-term contracts with Ontario Hydro and foreign utilities that ensure more or less stable output levels for the next several years.

Forestry

Logging activity has been strong in recent years. Wood harvests are expected to show a four per cent increase this year, reflecting higher demand by pulp mills which consume some 70 per cent of the wood harvested in Ontario. There will also be steady demand by other wood-using industries such as sawmills. However, harvests are expected to slacken somewhat in 1988, mainly as a result of a reduction in sawmilling activity. Forest regeneration activities are expected to continue to expand.

Manufacturing Sector Outlook

As the current economic expansion has matured, growth has become more broadly based across the manufacturing sector. This more balanced pattern of growth is expected to continue, but at a slower pace. The details are shown in Table 13.

Manufacturing Outlook for Ontario (\$1981) — **Table 13**

	1986		Real Output Annual % Change	
	Employment	Real Output \$Million	1987	1988-91
Manufacturing	**950,834**	**38,369**	**2.2**	**2.4**
Resource-based Industries	131,111	6,006	5.2	1.9
Transportation Equipment	141,884	7,002	(8.0)	3.3
Industrial Products	380,372	14,821	4.7	2.3
Consumer Products	297,467	10,541	4.1	2.2

Source: Conference Board of Canada, Statistics Canada and Ontario Ministry of Treasury and Economics.

Resource-based Manufacturing

In 1987, strong increases in real output are being achieved in the resource-based manufacturing industries, with more modest growth expected in following years. The success of Ontario's pulp and paper, wood products and primary metal industries depends to a large extent on world market conditions.

Strong North American demand has led to a record level of **pulp and paper** production in Ontario. This, coupled with increased prices, has resulted in substantially improved profits. The current boom is expected to extend through 1988 before slowing down. Longer-term projections of two to three per cent annual growth in world demand, and the availability of surplus forest resources in some parts of the province, suggest opportunities for expansion. Two companies are currently undertaking upgrading and expansion involving \$530 million.

Wood products production is also at a high level, owing to buoyant residential construction and renovation markets. Output is expected to decline by 1989 as residential construction returns to more moderate levels during the forecast period.

Ontario's **steel** industry has been relatively successful compared to its counterparts in the U.S. and other O.E.C.D. countries. Ontario steel production in 1987 is expected to have grown five per cent over last year. Mills have also made substantial capital investments -- $4 billion since 1980 -- to reduce costs and improve product quality. Overall prospects for the 1988-91 period remain good. The improved climate for energy-related investment will be of particular benefit to producers of steel pipe and tube such as Algoma Steel.

Transportation Equipment

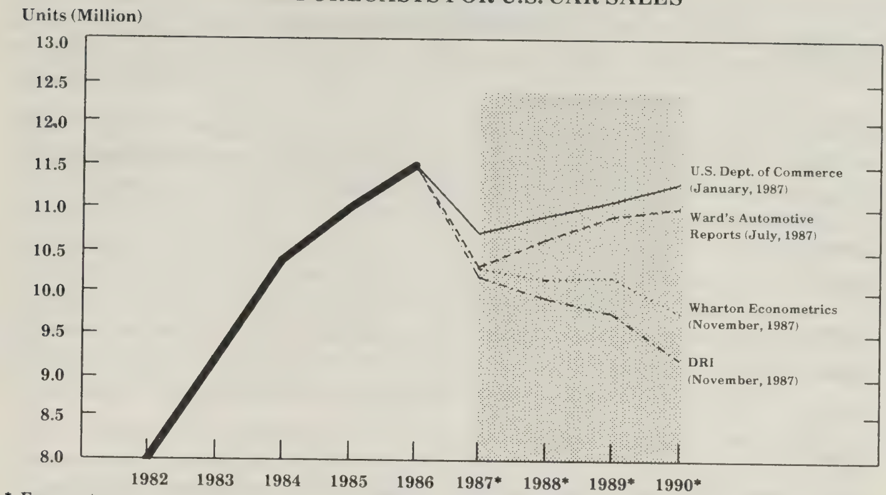
During 1987, the Ontario transportation equipment industry experienced a decline in output. In the first ten months of the year, Canadian vehicle production declined by 15.7 per cent, mainly due to lengthy shutdowns for plant conversions and slower than anticipated production start-ups at the new GM-10 car plant and the GMT-400 truck plant in Oshawa. For the rest of 1987, output will be further weakened by the elimination of one of two shifts at GM's #1 car plant in Oshawa. This plant is scheduled for changeover to GM-10 production in 1988. It also appears that an expected boost to production from Chrysler's new Bramalea plant (acquired from AMC) will be further delayed owing to start-up difficulties.

The outlook for the transportation equipment sector is dominated by the outlook for the auto industry which accounts for 85 per cent of transportation equipment shipments and employment. In turn, the outlook for the Ontario auto industry is primarily dependent on U.S. market conditions and the relative competitiveness of Ontario's industry vis-a-vis the U.S. and other countries, particularly Japan.

In 1986, Ontario accounted for 13 per cent of North American motor vehicle assembly capacity and exported 83 per cent of its production of motor vehicles (cars, trucks, and vans) to the U.S.

After four years of growth, culminating with a record sales level in 1986, U.S. car sales fell for the first ten months of this year. Forecasts call for declines for the year as a whole within a range of 10.1 per cent to 10.5 per cent. Following the stock market crash some recent U.S. forecasts have become more pessimistic about the outlook over the next few years as well. For 1988, further declines for the U. S. market are anticipated within the range of one to three per cent. These are lower than earlier forecasts, especially those by the U.S. Department of Commerce and Ward's Automotive Reports. The most pessimistic of these forecasts is unlikely, especially if 1991 is included in the forecast horizon.

FORECASTS FOR U.S. CAR SALES



* Forecast
Sources: As indicated.

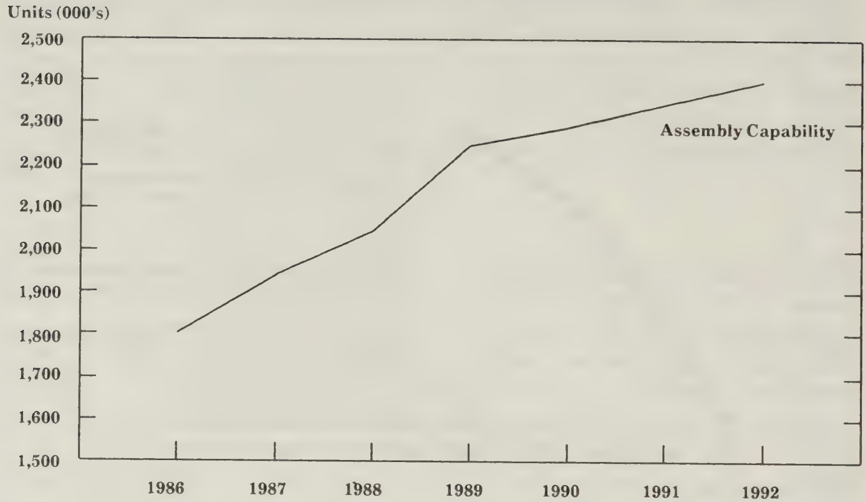
Despite Ontario's dependence on the U.S. automotive market and the softening outlook for that market in the near term, it is anticipated that Ontario's production will increase in 1988 as the industry recovers market share that was lost in 1987 due to plant conversions and model changeovers. It is also anticipated that Ontario production will generally increase through the 1989-91 period. This is expected to result from the bringing on stream of additional capacity now under construction, a gradual recovery in the U.S. auto market and increased market share for North American built autos (including Japanese North American production). Accordingly, Ontario's share of North American sales and North American production is expected to increase.

The reason for this expectation is that Ontario has a substantial competitive advantage stemming from a lower Canadian dollar, and lower labour, energy, and materials costs. Ontario has also benefitted from specialization in more successful product segments such as larger cars, mini-vans, and light trucks and vans.

The outlook for the medium term is further enhanced by technologically advanced additions to Ontario's assembly capability. Ontario's assembly capability by 1992 is expected to be roughly 600,000 units or 33 per cent ahead of that estimated for 1986. It is anticipated that this additional capacity, expected from both new and expanded plants, will be phased in gradually over the period. Most of this capability is expected to displace imports from Japan and fill market niches where the sales outlook is favourable.

The impact of the Canada-U.S. trade agreement on investment in the auto parts sector remains uncertain, particularly since the North American content rules for duty free status may be the subject of renewed negotiation. In any case, the proposed agreement does not contain safeguards with respect to the Canadian share of future investment from offshore in assembly or parts.

ADDITIONS TO ONTARIO'S AUTO ASSEMBLY CAPABILITY



Note: Assembly capability measures output potential. Annual changes to Ontario's assembly capability are estimated at less than total changes in planned plant capacity to reflect a gradual phase-in of new plants.

Source: Ontario Ministry of Treasury and Economics.

Industrial Products

Industrial product manufacturers include the machinery, fabricated metals, non-metallic minerals, electrical and electronic products, rubber and plastics, and chemicals and refining industries.

The **machinery** industry has rebounded strongly since the recession. The high level of Canadian industry investment spending for machinery and equipment expected this year has had a positive impact on the machinery industry in Ontario. However, this impact is, as always, somewhat diminished by the chronically high import content of business spending on machinery and equipment.

Shipments were up 14 per cent in the first half of 1987. The demand for manufacturing and services-related machinery and equipment should remain firm as should demand for forestry and pulp and paper machinery.

Continued steady growth is expected in the industry-oriented segment of the **electrical products** industry due to business investment in information technology and process equipment. The strong housing market has been a stimulus to appliance demand, but import penetration continues at very high levels.

A somewhat mixed performance is expected from **rubber and plastics**. The rubber component is experiencing weakness due to slack automobile demand and rationalization in the tire industry. Employment and output for rubber are declining as a result of the Goodyear tire plant closing earlier this year, and the Firestone closing announced for January 1988. The manufacturers of plastic products can be expected to pick up some

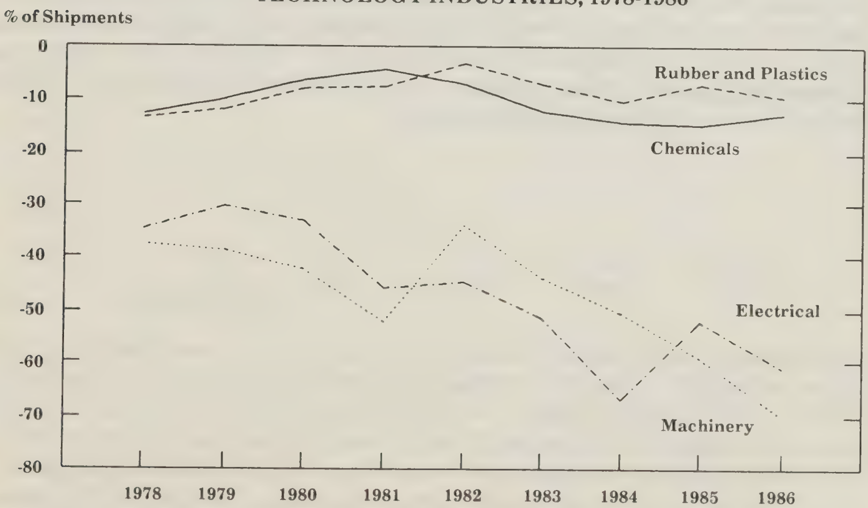
momentum over the short to medium term, continuing the general improvement in performance that began in 1983. Plastic products appear to have been capturing market share from more traditional materials such as metals and glass.

Over the short and medium terms, the **chemicals** group is expected generally to follow overall performance of the economy. Lower oil and gas prices have increased the competitiveness of synthetic products relative to natural products (metals, fibres, rubber) so that increasing displacement can be expected in the automotive, aircraft, electrical, textile, packaging, housing and consumer products industries. Research capabilities and efforts in Ontario are at the forefront of the industry in many areas. The plastics and resins, soap, toiletries and miscellaneous chemicals segments are expected to outperform the industry average while agricultural chemicals will exhibit below-average growth.

These industries – **rubber and plastics**, **machinery**, **electrical and electronic** products, and **chemicals** – were among those assigned a "high-technology" status by the Economic Council of Canada's 1987 study, Innovation and Jobs in Canada (based on value of high-technology inputs as a proportion of all non-labour inputs).

The chart below shows the export and import performances of the group as a whole over the period 1978 to 1986. During this period, although exports have been increasing, imports have been increasing at a greater rate. Ontario's international trade deficit on these goods grew from $4.0 billion in 1978 to $10.4 billion in 1986. Even as a percentage of total shipments, Ontario's international trade deficit in these goods has shown a steady worsening, especially since the recession.

ONTARIO TRADE DEFICIT FOR SELECTED HIGH TECHNOLOGY INDUSTRIES, 1978-1986



Source: Ontario Ministry of Industry, Trade and Technology and Ministry of Treasury and Economics.

In **petroleum refining**, the process of plant rationalization and modification has left Ontario refineries well adapted to meet efficiently the demand in the next decade. Modest increases in transportation fuel production will be partially offset by reduced production of heavy fuel oils and heating oils. Residential and commercial heating oils currently represent 13 per cent of petroleum product consumption (compared to 40 per cent ten years ago). Future capital and repair expenditures are likely to be around $150 million per year, down from recent levels of $250 million per year.

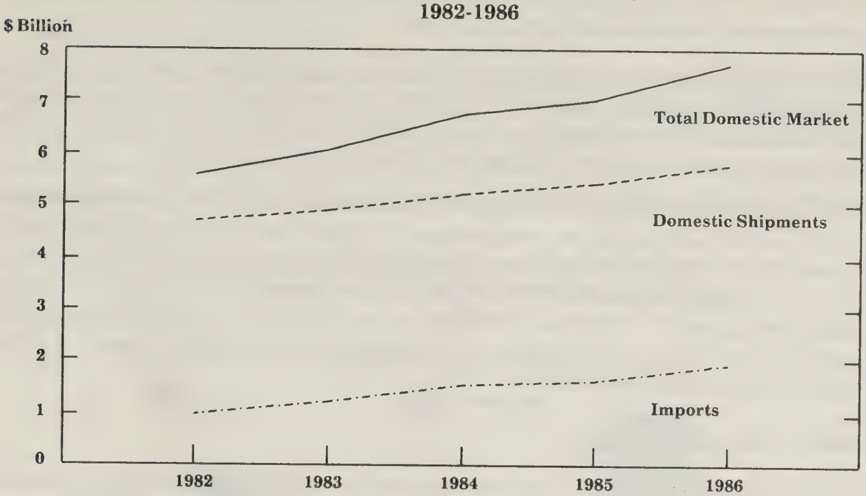
Shipments from the **fabricated metal** and **non-metallic products** industries increased by 9.2 per cent and 18.3 per cent respectively in the first half of 1987 over the same period last year. Strong capital investment continues to stimulate demand for metal doors and windows, heating equipment, cement, brick, glass, etc.

Consumer Products

This group includes the food, beverage and tobacco, leather, textiles and clothing, furniture, and printing and publishing industries. Steady growth is expected in both output and employment from this group of industries over the next four years.

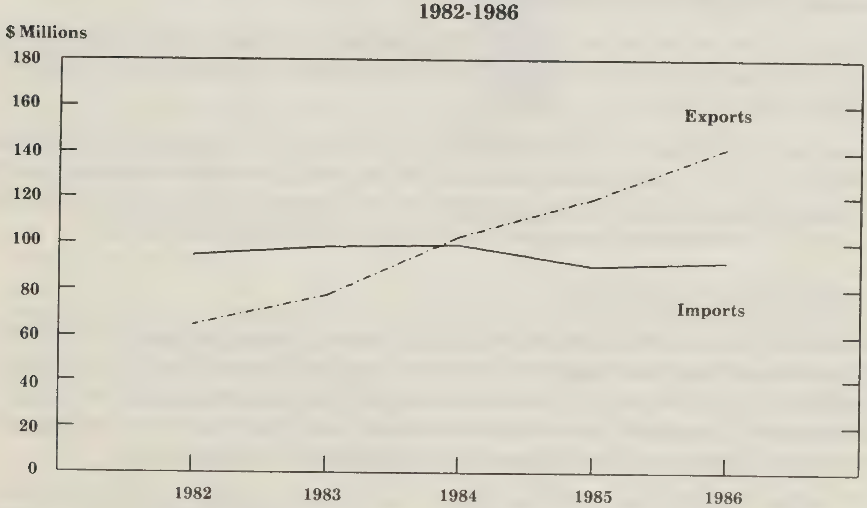
Increasing import penetration from lower-wage Asian producers in the **clothing and footwear** industries, and from high-volume U.S. operators in the **textiles** industry, continues to dampen performance in this sector. There are, however, some noteworthy exceptions to sluggish domestic production among the more specialized clothing designers and manufacturers. As the graphs below demonstrate, despite growing imports, domestic apparel shipments remain a significant proportion of the total and are increasing. In the case of apparel trade, imports are primarily from low-cost countries (both in terms of number of units as well as dollar value). Canadian exports, mostly to the United States, are of high-value items. Imports tend to be low-cost, low-value items. This in part explains a reversal in Canada's trade position in these products against the United States, from a deficit to a healthy surplus.

APPAREL SHIPMENTS AND IMPORTS, CANADA
1982-1986



Source: Canadian Textile Institute.

APPAREL INDUSTRY: CANADIAN TRADE WITH THE U.S.
1982-1986



Source: Canadian Textile Institute.

The **food and beverage** industry is the second largest, after transportation equipment, within the manufacturing sector in Ontario. There are 96,000 persons employed in this sector. Ontario's trade deficit in this sector is about $600 million. As a relatively small proportion of output is exported, the industry relies heavily on domestic consumption. Expansion has been restrained by slower population growth; but the snack food sector has been unusually strong and is expected to remain so with a steady stream of new

products. In competing with U.S. food processors, the industry's performance is hampered by higher costs.

Shipments in the **printing and publishing** industry increased by eight per cent in the first six months of 1987 over the same period last year. Capital investment is very strong - a total of $220 million anticipated for 1987 representing an increase of 72 per cent from the previous year.

The **furniture and fixtures** industry has been benefitting from high levels of new housing and office construction. Output has risen rapidly since the recession and the industry is now operating at full capacity with significant order backlogs and labour shortages. The medium-term outlook is for continued growth. For the next two years, the industry will continue to benefit from the large number of housing starts and high level of office construction in 1986 and 1987.

Service Sector Outlook

Since 1971, the service sector has averaged a real growth rate of 3.5 per cent per year, compared to 3.0 per cent for the economy as a whole. Employment growth in services has been equally impressive. The service sector also shows less cyclical variability in output. Even during the 1982 recession, when other sectors experienced varying degrees of setback, services managed 0.2 per cent growth in output.

Services are expected to continue to grow more strongly than the economy over the medium term. Real output in this sector will grow by 2.7 per cent per annum to 1991.

One sector of particular importance to Ontario's economy is financial services. This sector has recently witnessed dramatic changes in its international structure and its regulatory climate. Moreover, in the past month, the world stock market crisis has also had important effects.

Tourism Sector Outlook

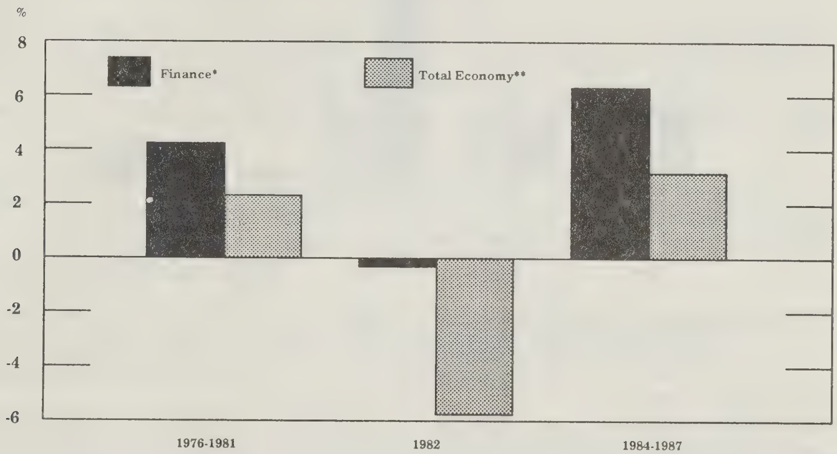
Growing real incomes in industrial countries, more personal leisure time and expanding business travel are causing the tourism market to expand rapidly. Ontario is well positioned with its good image, diverse society, strong economy and excellent location with respect to major tourism markets to compete for a larger share of this global megamarket.

Tourism is a major sector of the Ontario economy, accounting for 4.2 per cent of Ontario jobs. Following an exceptionally strong performance in 1986, tourism spending in Ontario is expected to have been over $9.3 billion this year. This is the second year of very strong growth. The currency realignments of recent years will improve Canada's attractiveness to the Japanese and Europeans. Currency changes will also encourage more Canadians to remain in North America.

Financial Services Outlook

The financial services industry is one of the most rapidly growing sectors of the Ontario economy and a major employer in the province. The industry was less adversely affected by the 1982 recession than other sectors and has since grown strongly. Although the recent declines in stock prices may cause a pause in growth, the medium-term outlook for this industry remains favourable.

AVERAGE ANNUAL EMPLOYMENT GROWTH IN FINANCIAL SERVICES AND TOTAL ECONOMY, ONTARIO
1976-1987



Note: 1983 growth rate is not available due to a break in the data series.
* Excludes insurance.
** Excludes agriculture, fishing, trapping, religious organizations, private household services and defence; pre-1983 also excludes public administration, education, health and welfare.

Source: Statistics Canada.

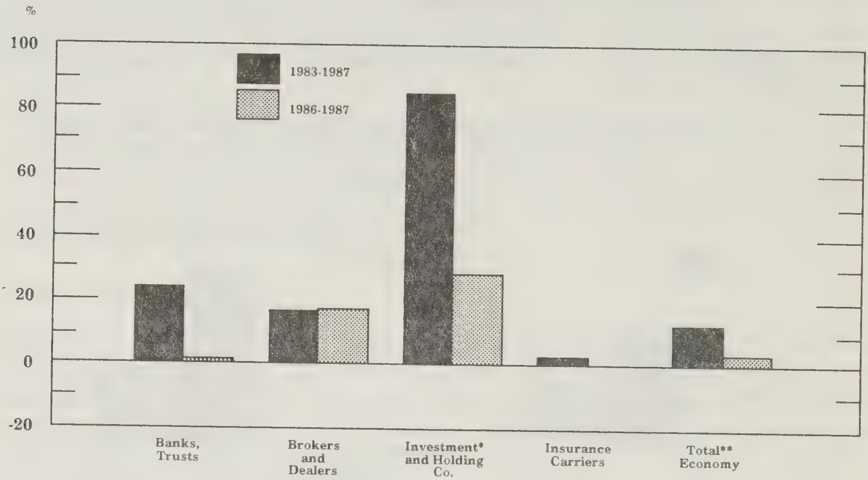
Banks and trust companies are by far the most important employers in Ontario's financial sector, providing 108,000 jobs and accounting for 55 per cent of this sector's employment. Insurance companies account for almost 25 per cent of financial sector employment, followed by investment and holding companies (9.9 per cent) and security brokers and dealers (6.7 per cent). Other credit agencies, including finance companies, account for less than four per cent.

Growth in employment since 1983 has been more evident in some industry segments than others, although in no segment has employment actually declined over the period as a whole. Investment companies (including mutual funds) have experienced the greatest surge. In the near term, investment companies and security brokers and dealers are the industry segments most likely to be affected by the recent declines in the stock market.

Employment in banks and trust companies has grown faster than in the economy as a whole since 1983. Insurance companies have experienced very little growth in employment over this period. Employment in banks, trust

and insurance companies is less likely to be directly affected by recent stock market conditions.

EMPLOYMENT GROWTH IN THE FINANCIAL SECTOR, ONTARIO 1983-1987



Note: Calculations based on employment in July, 1983, 1986, 1987.
* Includes mutual and closed-end funds.
** Excludes agriculture, fishing, trapping, religious organizations, private household services and defence.
Source: Statistics Canada.

The relatively rapid growth experienced by the industry in recent years reflects much longer-run trends. As consumer income has increased, and as the industry has developed new and more attractive vehicles to match saving and investment, the demand for financial services in Canada has expanded faster than the demand for goods and services generally.

Foreign ownership is expected to increase in financial services as regulatory constraints are removed. While before June 30, foreign-controlled securities firms accounted for less than ten per cent of the Ontario industry's capital, changes in the regulations have opened up opportunities for foreign firms. The changes in Ontario's securities regulations will lead to new entry and expansion of foreign firms in Toronto.

If the Canada-U.S. free trade agreement is approved, U.S.-owned banks will no longer be constrained by the limitation of the foreign-controlled share of domestic bank assets to 16 per cent and can be expected to increase their market share.

Increased taxes on the financial sector are expected as a result of tax reform. It is anticipated that the industry will be able to adjust to the new tax environment without major difficulty.

Ontario Fiscal Review

Revenue Structure*

This section provides a brief overview of Ontario's revenue structure and describes some of its key characteristics.

Composition of Provincial Revenues

The Province has a broad range of revenue sources including taxation, transfer payments from the federal government, other budgetary revenue and non-budgetary sources.

The three major taxation sources – personal income tax, corporation taxes, and retail sales tax – contribute 58 per cent of estimated total 1987-88 revenue. Taxation of gasoline and diesel fuels contributes a further 4.0 per cent. In total, approximately 66 per cent of 1987-88 revenue will be raised through taxation.

Transfer payments from the federal government account for 15 per cent of 1987-88 revenue. Within federal transfer payments, Established Programs Financing and Canada Assistance Plan payments account for 56 per cent and 26 per cent respectively.

Other budgetary revenue sources include OHIP premiums, fees and licences, LCBO profits, interest on investments and lottery profit revenue. These sources contribute 14 per cent of this year's revenue.

Non-budgetary revenues, including net deposits in trust accounts and net repayments of loans and investments, account for the remaining 5.0 per cent of total revenue.

Canadian Tax Reform

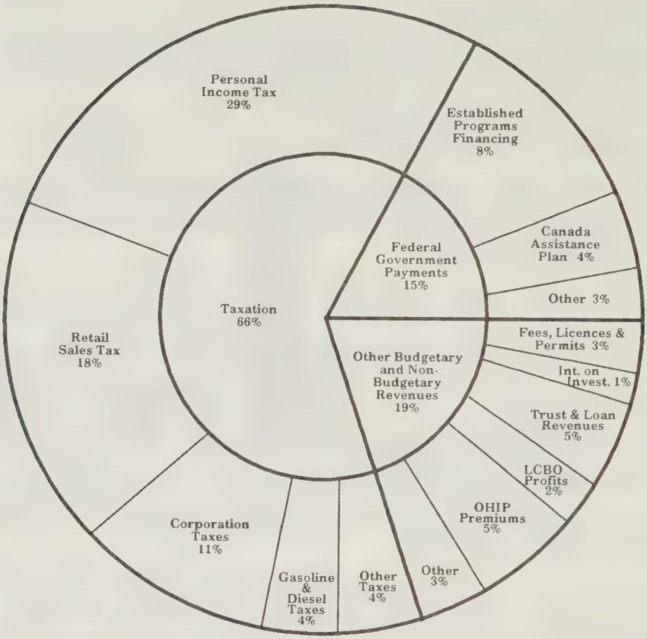
In June of this year, the federal government in Canada released its proposed package for tax reform. Reform has the potential to substantially change the structure of the Canadian tax system. The impact of the proposed federal reforms on individuals, business and the economy could be significant. Ontario has been assessing the social, fiscal and economic implications of these reforms which involve broadening tax bases and lowering rates.

Although the target date for the first phase of federal reform is January 1, 1988, the details of the legislation are yet to be finalized. Amendments will likely be made to the legislative package before implementation. As well, the content and implementation date of the second phase of federal reform, which is expected to center on a multi-stage sales tax, remains unclear. Once the details of the final federal legislation become known, supplemental information will be provided.

The following description reflects the existing tax system.

* All Ontario revenue figures for 1987-88 are based on the September 30, 1987, Ontario Finances.

COMPOSITION OF ONTARIO REVENUES 1987-88*



* **Forecast**
Source: Ontario Ministry of Treasury and Economics.

The Major Taxation Sources

Personal Income Tax

Under the terms of the Tax Collection Agreement between the Government of Canada and the Government of Ontario, the federal government collects and administers the Ontario personal income tax on behalf of the Province. The federal government determines the tax base i.e. establishes the definition of taxable income. Basic Federal Tax is calculated by applying a marginal rate structure to this base. Total federal tax is then determined by applying federal surtaxes and credits. Ontario personal income tax is defined as a proportion of Basic Federal Tax. For 1987, the Ontario rate is 50.0 per cent. In addition, a surtax of 3 per cent is applied to Ontario tax in excess of $5,000. Ontario income tax accounts for roughly one-third of an individual's total income tax.

The diagram below illustrates the operation of the personal income tax system.

THE PERSONAL INCOME TAX SYSTEM

Federally-Determined Base

- Total Income (Sum of Taxable Sources)
  Less: Deductions
- Net Income
  Less: Personal Exemptions
  Less: Deductions From Net Income
- Taxable Income
- Apply Federal Marginal Tax Rates

↓

Basic Federal Tax

↓ ↓

Federal	**Ontario**
• Add Surtax • Less Credits	• Apply Single Rate • Add Surtax • Less Tax Reduction • Less Credits
↓	↓
Federal Tax Payable	**Ontario Tax Payable**

With a few exceptions, such as social assistance payments and lottery winnings, all sources of income are subject to tax. Deductions and exemptions are provided for certain personal and income earning expenses. Provisions in the personal income tax system also support investment and saving for retirement.

The federal marginal tax rates for 1987, including federal surtaxes, range from 6.18 per cent in the lowest bracket to 35.02 per cent on income in the highest tax bracket. Ontario marginal rates, before consideration of surtaxes, are one-half of the basic federal rates. Actual Ontario rates after incorporating the Ontario surtax range up to a maximum of 17.51 per cent for 1987. Combining the two rate structures yields a 1987 maximum total marginal rate of 52.53 per cent.

Table 1 illustrates the marginal rate structures.

Federal and Ontario Marginal Personal Income Tax (PIT) Rates, 1987 — **Table 1**

Taxable Income $	Federal PIT Rate* %	Ontario PIT Rate*** %	Combined Federal/Ontario PIT Rates %
1,320 or Less	6.18	3.0	9.18
1,320 - 2,639	16.48	8.0	24.48
2,639 - 5,279	17.51	8.5	26.01
5,279 - 7,918	18.54	9.0	27.54
7,918 - 13,197	19.57	9.5	29.07
13,197 - 18,476	20.60	10.0	30.60
18,476 - 23,755	23.69	11.5	35.19
23,755 - 36,952	25.75	12.5	38.25
36,952 - 44,332	30.90	15.0	45.90
44,332 - 63,347	30.90	15.45**	46.35
over 63,347	35.02	17.51**	52.53

* Includes the 3% federal surtax.
** Includes the 3% Ontario surtax on Ontario tax over $5,000.
*** Does not include Ontario Tax Reduction.

Ontario has special programs to relieve tax burdens on low-income Ontarians. The Ontario Tax Reduction removes from the 1987 tax roll 500,000 individuals with taxable income of $2,075 or less. Another 50,000 individuals with taxable income between $2,075 and $2,275 pay reduced Ontario tax. There is no comparable federal tax reduction for low-income taxpayers. In addition, Ontario provides refundable Property and Sales Tax Credits that will return $360 million to Ontario taxpayers in respect of the 1987 tax year. The Property Tax Credit, claimed by the spouse with the higher taxable income, is equal to $230 plus 10.0 per cent of property tax or 2.0 per cent of rent. The Sales Tax Credit is calculated as 1.0 per cent of personal exemptions. These credits are collectively reduced by 2.0 per cent of taxable income. Over 90.0 per cent of these tax credit benefits are received by individuals earning less than $25,000.

Corporate Taxes

The Province of Ontario levies three general taxes on the corporate sector: Corporations Income Tax, Capital Tax and Insurance Premiums Tax. Mining companies are also subject to the Mining Tax. All corporations in Ontario, with the exception of insurance companies, are required to pay Capital Tax based on their paid-up capital. Insurance companies pay Insurance Premiums Tax based on the amount of premiums received in respect of Ontario policies.

The largest amount of corporate revenue is generated through the corporations income tax. Ontario determines the corporations income tax base and rate structure for the Province. Although significant differences have existed from time to time, Ontario's current base essentially parallels the federal corporate income tax base. Tax is imposed on gross corporate

revenues earned in the taxation year less allowable expenses. Various corporate activities receive special treatment through lower rates or accelerated deductions. Capital Taxes and Insurance Premiums Taxes are deductible expenses for federal and Ontario corporate income tax purposes.

The 1987 general corporations income tax rate is 15.5 per cent of taxable income. Income from manufacturing and processing operations, mining, logging, farming and fishing is taxed at the rate of 14.5 per cent.

Eligible small businesses are exempt from income tax in the first three years of their operation and pay tax at a 10.0 per cent rate thereafter.

Ontario, Alberta and Quebec administer their own corporations income tax. All other provinces have entered into tax collection agreements with the federal government.

Retail Sales Tax

The retail sales tax is payable on the sale of most goods and on certain services. The tax is calculated as a specific percentage of the final sale price to the consumer (including any federal levies). Since 1973, the general retail sales tax rate applying to most taxable items has been set at 7.0 per cent. Three other rates apply to specific items and services: 5.0 per cent on transient accommodation; 10.0 per cent on admission fees over $4 and beverage alcohol products sold at licensed establishments; and 12.0 per cent on beverage alcohol products sold at retail outlets.

A number of items are specifically exempt from retail sales tax. The most notable include groceries, energy used for heating and lighting, children's clothing, prescription drugs, specific reading material and production machinery and equipment. Most services are excluded from the retail sales tax base.

Ontario's retail sales tax base and rates are determined by the Province. Registered vendors collect the tax as agents of the Province and remit it to the government.

Motive Fuel Taxes

Ontario levies tax on motive fuels under the authority of two Acts - the Gasoline Tax Act and the Fuel Tax Act. Under both Acts, the tax base is applied to conventional petroleum-based products. Non-conventional fuels such as natural gas, propane, alcohol (used alone or blended with another fuel) and other manufactured gases are exempt.

Fuel taxes are levied on a per litre basis. The Provincial tax is 8.3 cents per litre on gasoline purchased in Ontario. This tax applies to licensed motor vehicles, snowmobiles and pleasure marine craft. Farming, commercial fishing, industrial, commercial, institutional, heating and cooking uses qualify for an exemption or a full rebate of taxes paid, provided that the fuel is consumed off-road.

All aviation fuels purchased in Ontario are subject to a tax of 1.88 cents per litre.

Diesel fuel purchased in Ontario for use in licensed on-road motor vehicles is subject to tax of 9.9 cents per litre. As with the gasoline tax, certain off-road

uses qualify for a full rebate of tax paid or are exempt at the time of purchase. A system of fuel colouration is in place to distinguish diesel fuels sold for exempt purposes, such as farming.

A tax of 3.1 cents per litre is applied to diesel fuel purchased in Ontario to power railroad locomotives.

Per Point Yields

Table 2 illustrates the 1987-88 revenue yield of selected revenue sources on a per point basis. The yields reflect a full year's revenue and in each case the tax points relate to a specific base.

Per Point Yield, 1987-88 **Table 2**

($ Million)

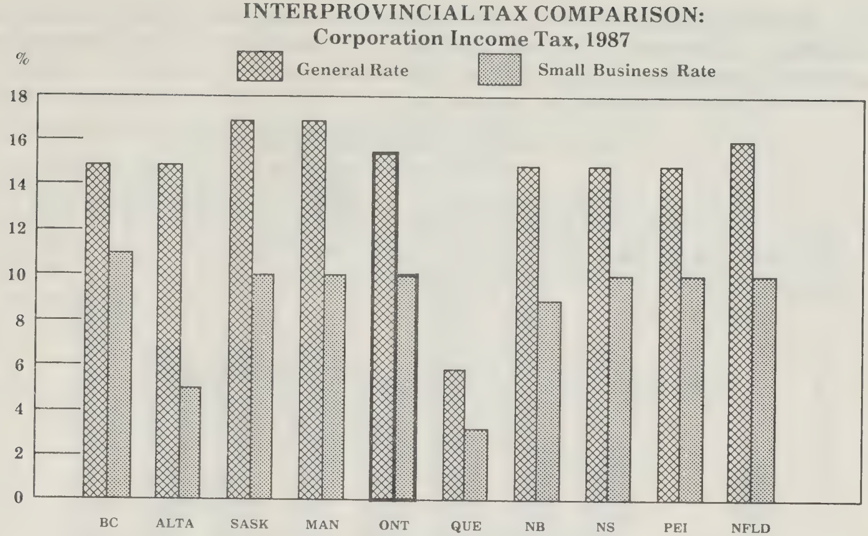
Retail Sales Tax			
7%	- General	822	
5%	- Transient Accommodation	11	
12%	- Alcohol (Retail Outlets)	26	
10%	- Alcohol (Licensed Premises) and Admission Fees	15	
Personal Income Tax		194	
Corporate Income Tax			
15.5%	- General	84	
14.5%	- Manufacturing and Processing, Fishing, Logging and Farming	77	
10%	- Small Business	55	
Capital Tax		166	Per 1/10 point
Tobacco Tax		11	1¢ per pack of 20
Motive Fuel Taxes			
Gasoline & Aviation Fuel		140	1¢ per litre
Road and Rail Diesel		35	1¢ per litre
OHIP Premiums (Individual and Family)		57	Per $1/$2
Land Transfer Tax		55	Per 1/10 point

Note: See text for interpretation of these data.
Source: Ontario Ministry of Treasury and Economics.

For example, one percentage point on the general retail sales tax rate yields approximately $822 million. The per point yield of the personal income tax is illustrated as an incremental percentage of Basic Federal Tax, and each percentage point yields $194 million.

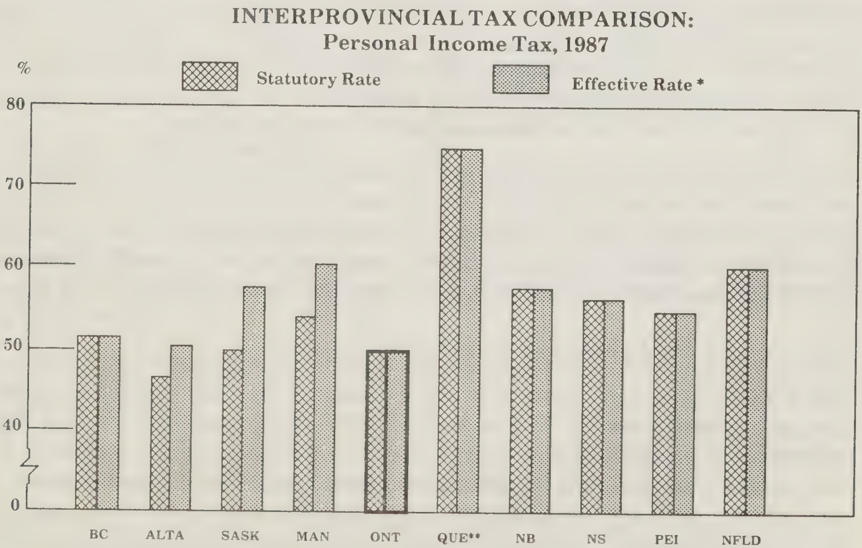
Interprovincial Comparison

As illustrated in the following chart, Ontario's general and small business corporate income tax rates are comparable with those in most Canadian provinces but are above rates in Alberta and Quebec.



Source: Ontario Ministry of Treasury and Economics and provincial tax statutes.

Provincial personal income tax rates and provincial personal income tax revenues as a percentage of Basic Federal Tax are illustrated below. Ontario's effective rate is 50.0 per cent, including the impacts of the Ontario Tax Reduction and surtax.



Notes: * Effective rate is total provincial income tax revenue, including any surtaxes and net of any tax reductions, as a percentage of basic federal tax assessed in the province.

** Estimated rate; Quebec does not impose tax as a percentage of basic federal tax.

Source: Ontario Ministry of Treasury and Economics and provincial tax statutes.

The general retail sales tax rates in Canada range from zero per cent in Alberta to 12.0 per cent in Newfoundland. Ontario's rate is approximately in the middle of the range at 7.0 per cent.

INTERPROVINCIAL TAX COMPARISON:
Retail Sales Tax, 1987

Note: * No provincial sales tax is imposed.
Source: Ontario Ministry of Treasury and Economics and provincial tax statutes.

Straight rate comparisons must, however, be used with caution. Differences in the taxable base are particularly important in interprovincial comparisons of retail sales tax. Significant interprovincial differences in retail sales tax exemptions exist in areas such as advertising, insurance premiums, transient accommodation and personal services.

Relative tax rates in these major tax areas also reflect the approach taken in each province to support health care expenditures. Ontario, Alberta and British Columbia raise additional revenue through Health Insurance Premiums ranging from $168 annually for a single individual in Alberta to $357 for an individual in Ontario. Quebec and Manitoba levy payroll taxes.

Ontario and Neighbouring U.S. Jurisdictions

Many of the proposed changes in the Canadian tax reform package follow changes made to the U.S. system. The U.S. Tax Reform Act of 1986 introduced a comprehensive overhaul of the U.S. federal tax system. The Act reduces personal and corporate income tax rates, and broadens the tax base by eliminating or scaling back many tax preferences. Overall, the new tax law significantly reduces personal income tax liability and increases corporate liability.

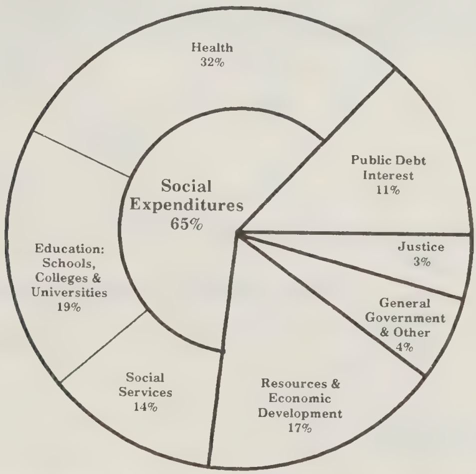
The need to maintain a competitive tax system with other jurisictions, particularly those in the United States, is a major objective of Canadian tax reform. The substantial difference in personal income tax rates between

Canada and the U.S. as well as the risk to Canadian corporation tax revenues from U.S. changes are critically important considerations for Ontario. However, a direct comparison between the tax systems in Ontario and neighbouring U.S. jurisdictions would be premature at this time because both systems are in transitional stages.

Expenditure Structure*

Provincial expenditures support a wide range of programs, services and capital projects. This spending will amount to approximately $35.2 billion in 1987-88. Key components of Ontario's expenditures are shown in the following graph.

DISTRIBUTION OF ONTARIO'S EXPENDITURES 1987-88 *



*** Forecast as at September 30, 1987**
Source: Ministry of Treasury and Economics.

Expenditures on social programs will account for 65 per cent of Provincial spending. These social expenditures include funding to support Ontario's health care and education systems, as well as social assistance programs and services.

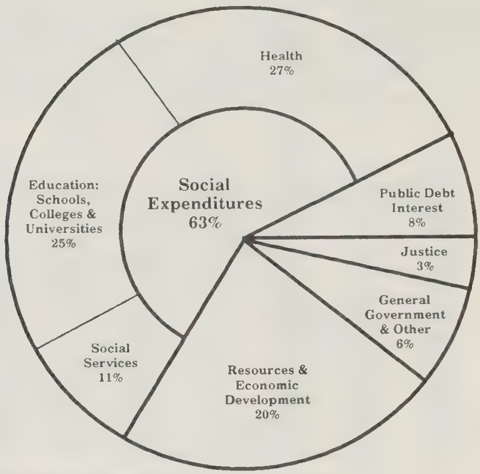
Provincial spending in support of resources and economic development will represent 17 per cent of Ontario's expenditures. This portion includes funding for the maintenance and construction of the transportation system, forest management programs, industrial and agricultural assistance programs, environmental protection and skills training.

Expenditures to support the administration of justice, the operation of Government and the Legislature will together account for 7 per cent. Interest payments on the public debt will represent another 11 per cent of Provincial spending this year.

* All Ontario Expenditure figures for 1987-88 are based on the September 30, 1987, Ontario Finances.

The distribution of Ontario's expenditures has changed since 1977-78. The key components are shown in the following graph.

DISTRIBUTION OF ONTARIO'S EXPENDITURES
1977-78



Source: Ontario Ministry of Treasury and Economics.

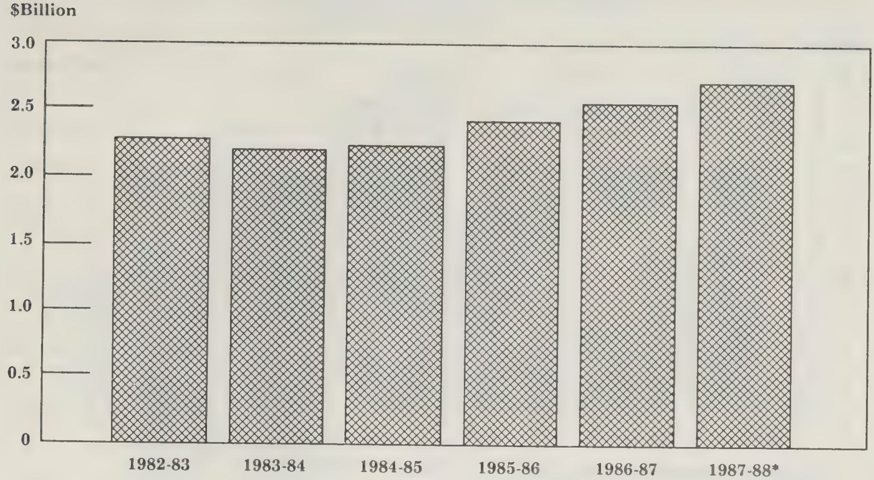
Expenditure on the Health, Social Services, Public Debt Interest components have increased as a proportion of the total spending while that of Education, Resources and Economic Development has declined since 1977-78.

Capital Expenditures

The Provincial Government directly, or indirectly through transfer payments, will provide \$2.7 billion for capital investments in 1987-88. Capital expenditures support the construction of roads, water and sewage facilities, hospitals, day nurseries and educational facilities. Also included is the purchase of transit equipment and joint capital projects with private industry.

During the six-year period from 1982-83 to 1987-88 capital spending ranged between \$2.2 billion and \$2.7 billion.

CAPITAL EXPENDITURES



* Forecast as at September 30, 1987
Source: Ontario Ministry of Treasury and Economics .

Fiscal Performance

Ontario's fiscal performance will be measured in terms of a number of the commonly used indicators. A 10 year review of Selected Financial and Economic Statistics can be found in the Appendix.

Net Cash Requirements

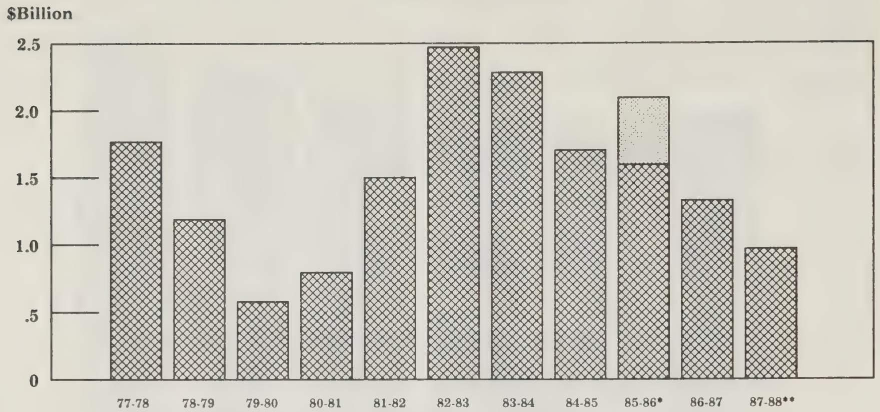
Net cash requirements (NCR) represent the shortfall between total revenues and total expenditures. Ontario's net cash requirement levels are a reflection of overall economic performance, stabilization policies and total spending.

Beginning in 1977, Ontario's net cash requirements experienced a downward trend which resulted in a low of $0.6 billion in 1979-80. In the early 1980's, a deterioration of world economic conditions had an adverse impact on Provincial finances, eventually leading to net cash requirements of almost $2.5 billion in 1982-83. In that fiscal year, net cash requirements as a proportion of total Provincial spending rose to 10.8 per cent, up from the 1979-80 proportion of 3.7 per cent.

Net cash requirements in 1987-88, at slightly less than $1.0 billion, are projected to be $1.5 billion less than the 1982-83 peak. As well, net cash requirements are expected to decline to 2.8 per cent of total spending.

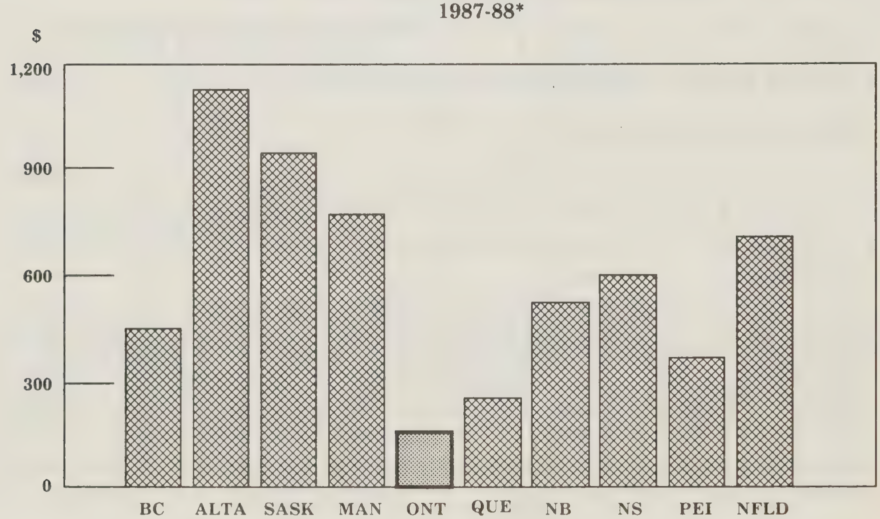
Ontario's net cash requirements per capita, at $106, are estimated to be the lowest among the provinces in 1987-88. It should be noted that this comparison has certain limitations in that financing for Crown corporations, public service pension funds and health insurance programs are treated differently by several provinces.

ONTARIO'S NET CASH REQUIREMENTS (NCR)
1977-78 to 1987-88



*Note: The shaded area represents NCR after extraordinary adjustments.
** Revised forecast as at September 30, 1987
Source: Ontario Ministry of Treasury and Economics.

NET CASH REQUIREMENTS PER CAPITA
1987-88*



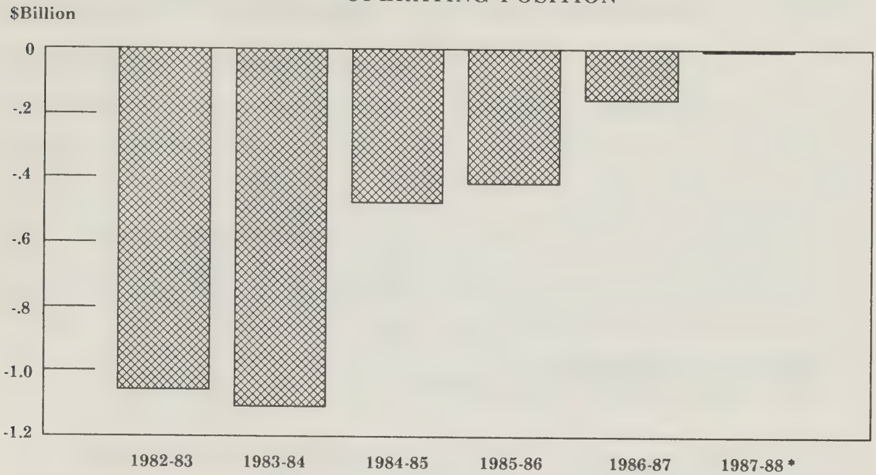
*** Forecast as at September 30, 1987**
Source: Ontario Ministry of Treasury and Economics.

Operating Position

The operating position is the difference between total current revenues and total current expenditures excluding capital expenditures. The operating position reflects the degree to which the Province pays for its day-to-day operating needs from its current revenues.

Ontario's operating position improved from a $1.1 billion operating deficit in 1982-83 to $0.2 billion in 1986-87, and is forecast to improve further to $15 million in 1987-88.

OPERATING POSITION



* Forecast as at September 30, 1987
Source: Ministry of Treasury and Economics.

Total Debt as a Per Cent of Gross Domestic Product

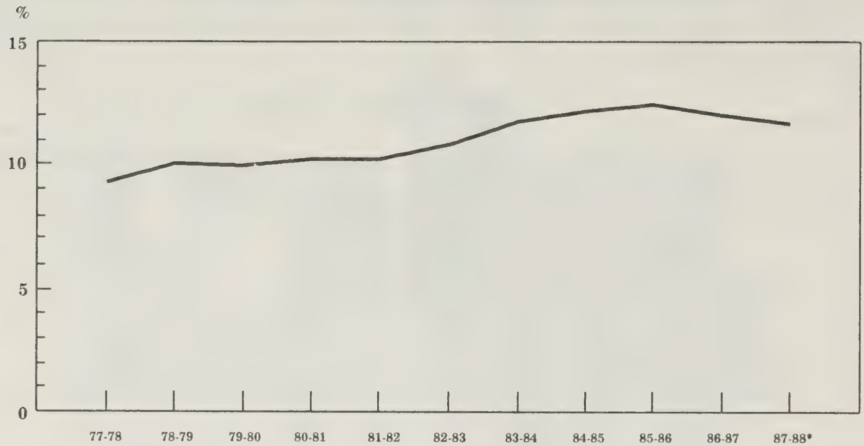
Ontario's total debt comprises funded and unfunded debt. Funded debt has a specified term to maturity and is secured by a debt instrument such as a bond or Treasury Bill. Unfunded debt is not secured by debt instruments.

The capacity of a government to carry its debt is largely determined by the underlying strength of the economy and tax revenues. The ratio of total debt to GDP rose to 17.8 per cent in 1978-79 and then fell to 16.2 per cent in 1981-82. It increased to 18.1 per cent in 1983-84 but is forecast to fall to 16.8 per cent in 1987-88.

Public Debt Interest

Public debt interest (PDI) costs for servicing total debt absorbed an increasing share of budgetary revenues until 1985-86. Public debt interest costs grew from 9.3 per cent of budgetary revenues in 1977-78 to 12.4 per cent in 1985-86. Thereafter, public debt interest costs fell to 12.0 per cent of budgetary revenues in 1986-87. In 1987-88, public debt interest costs are expected to fall further to 11.7 per cent of budgetary revenues.

PDI AS A PER CENT OF BUDGETARY REVENUE

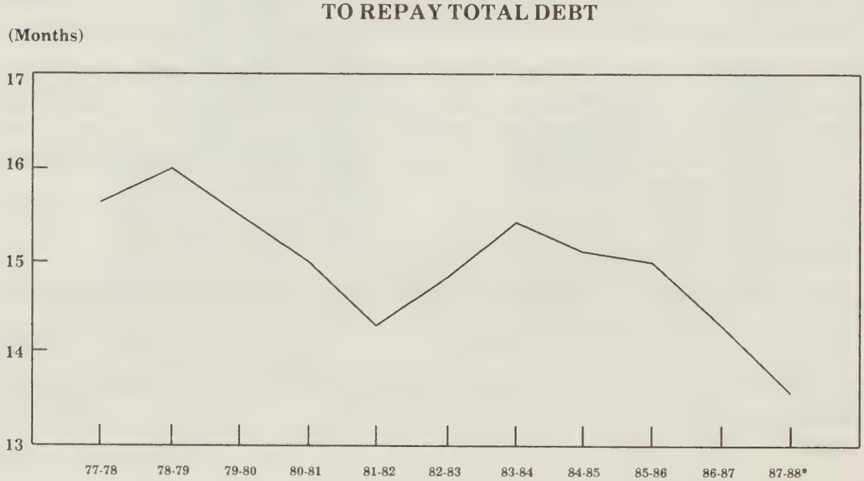


* Forecast as at September 30, 1987
Source: Ontario Ministry of Treasury and Economics .

Months of Budgetary Revenue Required to Repay Total Debt

Since 1977-78, the number of months of budgetary revenue required to repay total debt has ranged from a high of 16.0 months in 1978-79 to a low of 14.3 months in 1986-87. It would take an estimated 13.6 months of budgetary revenue to repay total debt in 1987-88.

MONTHS OF BUDGETARY REVENUE
TO REPAY TOTAL DEBT



* Forecast as at September 30, 1987
Source: Ministry of Treasury and Economics

Fiscal Capacity and Tax Effort

Fiscal capacity measures the relative ability of a province to raise revenues from available revenue sources. Tax effort measures the relative extent to which each province taxes those available revenue sources. In this section, these measures are used to make interprovincial comparisons.

Determination of Fiscal Capacity

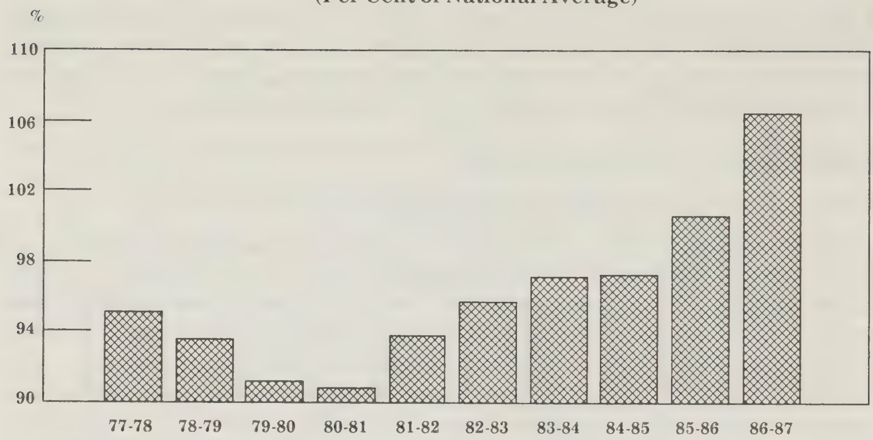
Fiscal capacity can be measured by a number of different indices.

The Representative Tax System (RTS) is the one used by the federal and provincial governments as a measurement of fiscal capacity. In the Representative Tax System, each revenue source has an associated tax base and the fiscal capacity can be related to population. For example, the base for tobacco taxes is the number of cigarettes sold in a province. If a province's share of a base is lower than its population share, that province is said to have a fiscal capacity deficiency in that tax base. If the opposite is true, a fiscal capacity surplus exists. In other words, a province has a fiscal capacity deficiency in a tax base if its per capita share of a base is less than the national average.

Tax bases are defined according to the taxing practices of provinces. For example, if an item such as infants' clothing is exempt from the retail sales tax in a majority of the provinces, such sales would not be included in the tax base. Hence, the term "representative".

Employing data from the federal equalization program, it is possible to derive an aggregate tax base share by "adding" together 37 different provincial and local tax bases. This provides a single but comprehensive measure of a province's relative fiscal capacity. In 1986-87, Ontario's fiscal capacity, measured on this basis for provincial own-source revenues, was 106.5 per cent of the national average. The chart below indicates how Ontario's fiscal capacity has varied over the past ten years. The range of fiscal capacities in 1986-87 was 60.9 per cent for Newfoundland to 155.4 per cent for Alberta.

FISCAL CAPACITY OF ONTARIO
(Per Cent of National Average)



Source: Department of Finance, Canada and Ontario Ministry of Treasury and Economics.

As Table 3 shows, if federal transfer revenues are added to provincial-local own-source revenues, the fiscal capacity of "have-not" provinces approaches the national average. Since federal transfers are relatively greater for the "have-not" provinces, the relative fiscal capacities of the "have" provinces decline. For example, Ontario's 1986-87 fiscal capacity declines about 8.0 percentage points to 98.4 per cent of the national average, primarily because the Province does not receive federal equalization payments.

Indices of Provincial-Local Fiscal Capacity, 1986-87 **Table 3**

(Per Cent of National Average)

	Provincial-Local Own-Source Revenues	Provincial-Local Own-Source Revenues plus All Federal Transfers
Newfoundland	60.9	94.0
Prince Edward Island	63.2	98.1
Nova Scotia	75.0	94.9
New Brunswick	70.5	97.3
Quebec	84.2	92.4
Ontario	**106.5**	**98.4**
Manitoba	84.5	92.9
Saskatchewan	92.1	94.1
Alberta	155.4	138.5
British Columbia	102.8	99.0
National Average	100.0	100.0

Source: Department of Finance, Canada.

Included in the determination of federal transfers are special contracting-out tax points that Quebec opted for in lieu of a portion of federal cash contributions under the Canada Assistance Plan and Hospital Insurance. The latter contributions were subsequently rolled into Established Programs Financing.

Determination of Tax Effort

A comparison of provincial tax rates on individual revenue sources is often employed as a gauge of relative revenue-raising efforts. However, such comparisons alone do not provide a way of assessing a province's overall tax effort.

As with the determination of fiscal capacity, tax effort can be measured by individual revenue sources. For each revenue source, a national average tax rate can be calculated by dividing the provincial revenues collected by the total all-province tax base.

A comprehensive measure of tax effort can be calculated by dividing a province's share of total provincial-local revenues by its share of total tax base. In order to determine a province's share of the aggregate tax base, each of the revenue sources must be weighted to reflect the relative importance that is attached to them individually. For example, if personal income tax (PIT) revenues account for 27 per cent of the total ten-province revenues, the weight of personal income tax in the comprehensive tax base would be 27 per cent. Each province's share of this weighted tax base is calculated by multiplying its percentage share of the personal income tax base by this weighted percentage. In the case of Ontario, the Province's share of the personal income tax base, 39 per cent, is multiplied by the weighted personal income tax base of 27 per cent to derive Ontario's percentage share of the personal income tax portion of the comprehensive tax base (i.e., 10.5 per cent). Ontario's share of the comprehensive tax base is determined by summing together the individual percentage shares of the 37 revenue source comprehensive tax base components.

This measure of tax effort indicates to what extent a province is taxing what is available to be taxed, relative to the national average. Local revenues are included because of the varying responsibilities that individual provinces allocate to their local governments. Table 4 provides the indices of relative tax effort for 1986-87 on this comprehensive basis.

Indices of Provincial-Local Tax Effort, 1986-87 **Table 4**
(Per Cent of National Average)

Newfoundland	107.0
Prince Edward Island	93.6
Nova Scotia	98.2
New Brunswick	99.8
Quebec	126.1
Ontario	**104.6**
Manitoba	106.0
Saskatchewan	96.8
Alberta	68.2
British Columbia	99.8
National Average	100.0

Source: Department of Finance, Canada.

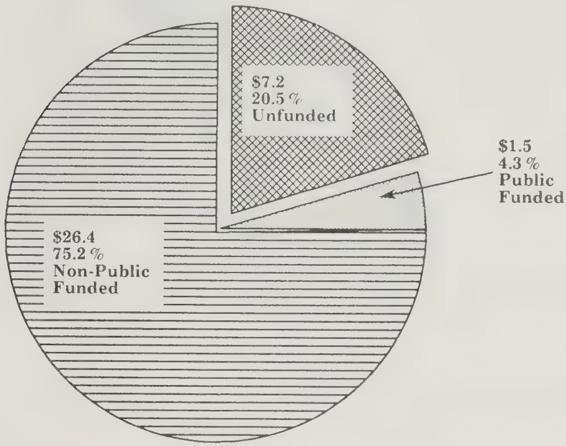
Ontario's overall tax effort slightly exceeds the national average. Alberta's tax effort is about 32 per cent below the national average, mainly because it levies no sales or gasoline tax, and has the lowest personal income tax. Since Alberta's share of oil and gas revenues is about the same as its share of oil and gas tax bases, its resource taxation does not bias its tax effort one way or another.

Quebec has a very high tax effort, some 26 percentage points above the national average in 1986-87. Despite high rates of taxation on certain revenue sources, the Maritime provinces do not have a high degree of overall tax effort, due in large part to their relatively low levels of local property taxation.

Debt and Debt Financing*

Ontario's Debt

COMPOSITION OF ONTARIO'S OWN-PURPOSE TOTAL DEBT
March 31, 1987
($Billion)



Source: Ontario Ministry of Treasury and Economics.

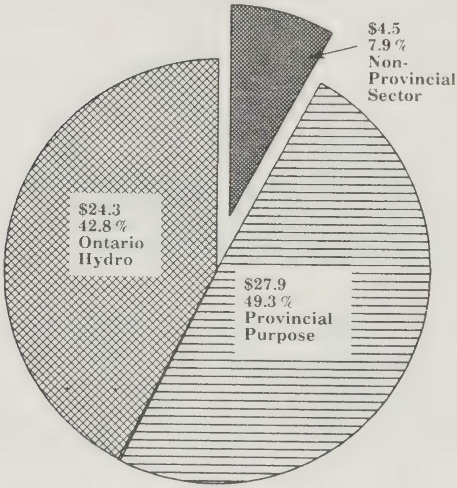
Ontario's own-purpose total debt consists of funded and unfunded debt. Funded debt, the largest portion, has a specified term to maturity and is secured by a debt instrument such as a bond or Treasury Bill. Ontario's funded debt is concentrated in non-public debt, owed primarily to the Canada Pension Plan (CPP) and the Teachers' Superannuation Fund (TSF) in the form of long-term, non-marketable securities at market-related rates of interest. Debt owed to the general public is about 4.0 per cent of the Province's total debt. The Province's estimated funded debt at March 31, 1988 will be $29 billion of which about 90 per cent will be owed to the CPP and TSF.

Unfunded debt refers to obligations that are not secured by a debt instrument such as deposits with the Province of Ontario Savings Office and for the Public Service Superannuation Fund. Unfunded debt represents 20.5 per cent of Ontario's total debt, up from about 15 per cent ten years ago. Ontario's own-purpose total debt will be about $37 billion by the end of fiscal 1987-88 compared to $16.5 billion ten years ago.

* All Ontario debt figures for 1987-88 are based on the September 30, 1987 Ontario Finances.

Consolidated Public Sector Funded Debt

CONSOLIDATED PUBLIC SECTOR FUNDED DEBT
March 31, 1987
(Interim, $Billion)



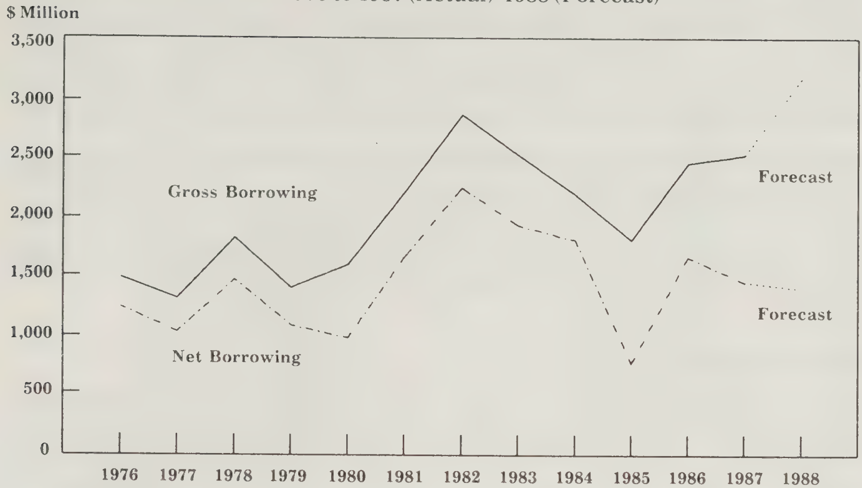
Source: Ontario Ministry of Tresury and Economics.

The broadest measure of funded debt in the Ontario Public Sector is Consolidated Public Sector Funded Debt which includes debt incurred at all levels of Provincial jurisdictions. The preponderance of Provincial and Provincially guaranteed debt in this measure illustrates Ontario's policy of centralizing public sector financing at the Provincial level. Ontario's direct and guaranteed funded debt, which is over 90 per cent of the consolidated debt, consists of obligations for the Province's own purpose or for Ontario Hydro. Due to Ontario's policy of centralized financing, there is a limited requirement for public borrowing by local bodies, colleges and hospitals. Internal funds and Provincial grants finance a large proportion of local capital expenditures, with the remainder financed by borrowing. Local government debt is 5.0 per cent of consolidated funded debt while less than one-half of one percent consists of the obligations of universities, colleges and hospitals. The Provincial (direct and guaranteed) share of Consolidated Public Sector Funded Debt has been rising over time reflecting the policy of centralized financing.

Hydro Borrowing

In 1987 and 1988, Ontario Hydro's annual gross borrowing is expected to be around $2.5 and $3.2 billion respectively, with borrowing net of retirements amounting to $1.4 billion in both 1987 and 1988. The higher gross figure for 1988 is due largely to the proposed call and refinancing of three high interest cost issues. Even though it is unlikely that Hydro's gross borrowing needs will put undue pressure on the capital markets, the Province will

ONTARIO HYDRO BORROWING
1976 to 1987 (Actual) 1988 (Forecast)

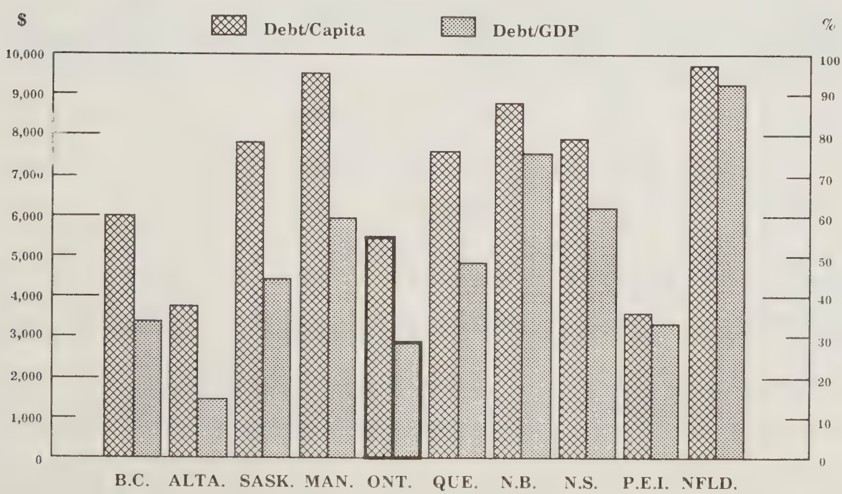


Source: Ontario Hydro.

continue to monitor Hydro's financing needs and plans to ensure that they are consistent with the Province's fiscal and financial plans.

Interprovincial Comparisons

INTERPROVINCIAL FUNDED DEBT COMPARISONS
December 1986



Source: Bank of Canada Review.

Interjurisdictional debt comparisons usually focus on funded debt measures because this assures a standard of conceptual uniformity and comparability across jurisdictions and over time. Similarly, in order to avoid the

inconsistencies caused by provinces assuming different types of debt at different levels of the public sector, the sum of funded debt owed by a province and debt guaranteed by a province is used in interprovincial comparisons. Nevertheless, the comparisons remain limited by differences in treatment across provinces of sinking funds and purchases by public sector investment funds such as the Alberta Heritage Savings Trust Fund.

Ontario's direct and guaranteed debt burden is relatively low compared to other provinces. In 1986, Ontario owed $5,544 per person. This was the third lowest level of direct and guaranteed debt per capita in Canada, higher only than Prince Edward Island and Alberta. Ontario had the second lowest level of debt as a per cent of Gross Domestic Product (29 per cent), after Alberta.

Ontario's Financing

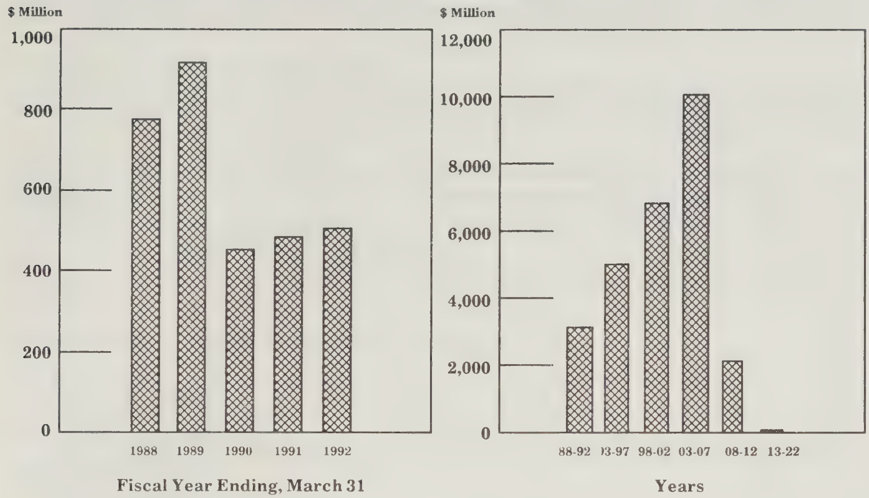
The Province of Ontario has available for its financing purposes the funds of the Teachers' Superannuation Fund (TSF) and Ontario's share of the Canada Pension Plan (CPP) as well as domestic and international capital markets. Because of the structure of contributions and benefits of these two pension plans, they have been a growing source of financing for Ontario. In 1987-88, non-public availability exceeds the Province's needs and consequently, Ontario has declined most of the CPP funds available to it.

Ontario's Maturing Debt

Approximately 11.5 per cent of Ontario's funded debt (excluding Treasury Bills) is scheduled to mature in the five-year period from April 1987 to March 1992 and 30 per cent in the ten years from 1988 to 1997.

In the five year period ending March 1992, maturities (excluding Treasury Bills) will total $3.1 billion, with 70 per cent representing retirements of Canada Pension Plan obligations.

ONTARIO DEBT MATURITY



Source: Ontario Ministry of Treasury and Economics.

Credit Worthiness

Provincial Ratings October 1987 — **Table 5**

	Standard and Poor's (S&P)	Moody's	Canadian Bond Rating Service (CBRS)	Dominion Bond Rating Service (DBRS)
British Columbia	AA	Aa2	AA	AA (low)
Alberta	AA+	Aa1	AA	AA
Saskatchewan	AA–	A1	AA–	A (high)
Manitoba	A+	A1	AA–	A
Ontario	AA+	Aaa	AAA	AA
Quebec	AA–	Aa3	A	A (high)
New Brunswick	A+	A1	A	A
Nova Scotia	A–	A2	A–	A (low)
Prince Edward Island	NR*	A3	BBB+	A (low)
Newfoundland	A–	Baa1	BBB	BBB

* Not Rated.

Source: Ontario Ministry of Treasury and Economics, Canadian Bond Rating Service, Dominion Bond Rating Service, Moody's Bond Survey and Standard and Poor's CreditWeek.

The 1980s have been a period of general pressure on Canadian provincial credit ratings. In 1986 and 1987 to date, four provinces have been downgraded by Standard and Poor's, Moody's (two U.S. rating agencies) or by the Canadian Bond Rating Service because their economic performance has been weak or their fiscal and financial performance has not matched their economic improvements.

In mid-1986, Ontario was upgraded by the Canadian Bond Rating Service to an unqualified AAA from AAA-. In addition, Moody's raised Quebec to Aa3 from A1 and New Brunswick to A1 from A2.

Dominion Bond Rating Service started rating the Canadian provinces in 1987. Ontario and Alberta received AA, the highest rating of all provinces.

Rating Adjustments in 1986 and 1987 **Table 6**

	Rating Change	
British Columbia	Downgraded from:	Aa1 to Aa2 (Moody's)
Alberta	Downgraded from:	Aaa to Aa1 (Moody's) AAA to AA+ (S&P) AAA to AA (CBRS)
Saskatchewan	Downgraded from:	AA to AA– (S&P) Aa3 to A1 (Moody's) AA to AA– (CBRS)
Manitoba	Downgraded from:	AA– to A+ (S&P)
Ontario	Upgraded from:	AAA– to AAA (CBRS)
Quebec	Upgraded from:	A1 to Aa3 (Moody's)
New Brunswick	Upgraded from:	A2 to A1 (Moody's)

Source: Ontario Ministry of Treasury and Economics, Canadian Bond Rating Service, Moody's Bond Survey and Standard and Poor's CreditWeek.

Federal-Provincial Funding Programs

The following sections describe the two major programs through which the Province receives substantial federal funding: the fiscal arrangements and the Canada Assistance Plan.

Federal-Provincial Fiscal Arrangements

Introduction

The federal-provincial fiscal arrangements are the institutional vehicles through which the federal government transfers funds to the provinces as part of its historical commitment to certain national shared-cost programs, and to the principle of interprovincial fiscal capacity equalization. The largest of these payments is made in respect of health care and post-secondary education under Established Programs Financing. Funds are also transferred under the Equalization program, the Fiscal Stabilization program, and the Personal Income Tax Revenue Guarantee.

Although often discussed in terms of federal-provincial negotiation and agreement, it should be noted that the fiscal arrangements are under the sole legislative and administrative control of the federal government. Every five years, legislation in this area is drafted and enacted by the federal government, and requires no provincial enabling legislation, support or

even agreement to operate. In practice, however, Ottawa has consulted with the provinces on potential revisions to the legislation prior to enactment.

Established Programs Financing

Adopted in 1977 to replace the federal-provincial shared-cost programs in the fields of health and post-secondary education, Established Programs Financing was regarded as a milestone in co-operative federalism in Canada. The essence of the new arrangement was that the provinces, long dissatisfied with the cumbersome and inflexible nature of the cost-sharing arrangements, were given greater policy and administrative latitude through a move to block funding. At the same time, Ottawa lessened its financial risk by tying its contributions to the rate of growth of the national economy rather than to provincial expenditures.

At a Conference of First Ministers held in June 1976, the broad framework for Established Programs Financing was introduced. At that time, the Prime Minister outlined five principles that would form the basis of the federal approach*:

- The federal government should continue to pay a substantial share of program costs.
- The federal payment should be calculated independently of provincial program expenditures.
- There should be greater equality, in per capita terms, in the federal contributions to the provinces.
- The arrangements for the mature programs should be placed on a more permanent footing.
- There should be provision for continuing federal participation in the development of policies of "national significance" in health and post-secondary education.

The Prime Minister also emphasized that the federal government intended to encourage provincial spending restraint through the new arrangement.

There was widespread provincial acceptance of most of these principles, and a federal-provincial consensus on the course that was being charted. However, shortly after the new arrangement had been agreed upon, the federal government decided to keep track of the individual cash components of the transfers for health and post-secondary education. While not consistent with the principle of block funding, the split was for federal bookkeeping purposes only and did not require provinces to demonstrate that they had, in fact, spent the funds in these areas.

The Canada Health Act illustrates the federal government's attempts to "reconditionalize" Established Programs Financing. Passed by Parliament

*Statement tabled by the Prime Minister of Canada, the Right Honourable Pierre Elliott Trudeau, on the occasion of the Conference of Federal and Provincial First Ministers, held in Ottawa, June 14 and 15, 1976.

in 1984, the Act sets program criteria and conditions of payment for the cash portion of transfers paid to the provinces for insured health-care services and extended health care. Under the terms of the legislation, each province's health insurance plan must satisfy federal requirements respecting comprehensiveness, portability, universality, accessibility and public administration.

The federal government is empowered to withhold a portion of the provincial transfer payments equal to the amount that physicians bill above the rates set out in the provincial fee schedules. Dollar for dollar deductions are also imposed on provinces which permit user charges. Between July 1984 and June 1986, over $106 million in payments to Ontario were withheld by the federal government. The Province has since complied with the conditions of the Canada Health Act by eliminating extra-billing for insured health services, and has recouped the amount withheld.

As shown in Table 7, the federal government has taken a number of further actions to restrain the growth of its payments to the provinces. When the fiscal arrangements were amended in 1982, the Revenue Guarantee Compensation, which was built into Established Programs Financing as part of the 1977 agreement, was removed. This effectively eliminated a portion of the per capita entitlements.

Established Programs Financing transfer growth is based on both growth in the economy and population increases for individual provinces. Under the two-year federal "6 & 5" restraint program introduced in June 1982, per capita limits were imposed on post-secondary education transfer growth.

Most recently, the federal government's Bill C-96, An Act to Amend the Federal-Provincial Fiscal Arrangements and Federal Post-Secondary Education and Health Contributions Act, 1977, received Royal Assent in June 1986. It reduces the annual growth in per capita Established Programs Financing transfers by two percentage points. In 1987-88, Bill C-96 will reduce Ontario's Established Programs Financing entitlements by $250 million. Taken together, the reductions in Established Programs Financing entitlements for Ontario amount to $812 million in 1987-88.

Provincial Losses Due To Federal EPF Cuts Since 1982 (\$ Million) — **Table 7**

	Elimination of Revenue Guarantee Compensation		"6 & 5" Caps on Post-Secondary Education Transfers		Reduction of EPF Escalator	
	Ontario	All Provinces	Ontario	All Provinces	Ontario	All Provinces
1982-83	294	830	–	–	–	–
1983-84	325	917	44	125	–	–
1984-85	356	1,002	95	264	–	–
1985-86	384	1,076	102	286	–	–
1986-87	413	1,159	110	308	114	317
1987-88	444	1,243	118	330	250	678
TOTAL	2,216	6,227	469	1,313	364	995

Source: Department of Finance, Canada and Ontario Ministry of Treasury and Economics.

Federal support for Ontario health and post-secondary education programs has fallen from a peak of 52 per cent of provincial-local spending for these purposes in 1979-80, to about 40 per cent in 1986-87. Since Established Programs Financing tax point transfers are derived from provincial taxpayers, they can be regarded as provincial revenues. Thus, if the federal contribution is considered solely in terms of the Established Programs Financing cash component, then Ottawa's current share of combined health and post-secondary education spending in Ontario would amount to only 22 per cent, down from 30 per cent in 1979-80.

Equalization

Equalization payments are unconditional transfers from the federal government to qualifying provinces, with the purpose, as enshrined in Section 36 of the Constitution Act, 1982, of ensuring that provincial governments have sufficient revenues to provide "reasonably comparable levels of public services at reasonably comparable levels of taxation". The actual determination of equalization entitlements has evolved over the years by refinements and adjustments to the formula since the inception of the program in 1957. Although there have been disagreements about these changes, some of which had quite dramatic effects, all provinces have supported the overall thrust of the program.

Ontario has never been an equalization recipient. Indeed, when oil price shocks created the possibility of Ontario receiving equalization payments, these equalization payments were prevented through retroactive legislative amendment in 1981.

Determining the extent to which the goals of equalization are being achieved is difficult due to the lack of a definition or measure of "reasonably

comparable levels of public services at reasonably comparable levels of taxation". As was discussed in the section on fiscal capacity and tax effort, the equalization program takes into account 37 distinct revenue sources. These sources and the estimated provincial revenues to be equalized for 1987-88 are summarized in Table 8.

Fiscal Equalization, 1987-88 **Table 8**
($ Billion)

Revenue Source	Amounts Subject to Equalization
Personal Income Tax Revenues	25.9
Business Income Revenues	5.0
Capital Tax Revenues	1.3
General and Miscellaneous Sales Taxes	14.6
Tobacco Taxes	2.1
Gasoline Taxes	3.0
Diesel Fuel Taxes	0.8
Non-Commercial Vehicle Licences	1.3
Commercial Vehicle Licences	0.5
Revenues from the Sale of Spirits	1.5
Revenues from the Sale of Wine	0.5
Revenues from the Sale of Beer	0.8
Hospital and Medical Insurance Premiums	2.3
Race Track Taxes	0.1
Natural Resource Revenues **	3.5
Insurance Premium Revenues	0.5
Payroll Taxes	2.1
Provincial-Local Property Tax Revenues	17.6
Lottery Revenues	1.2
Miscellaneous Provincial-Local Taxes and Revenues	7.5
Shared Revenues: Off-shore Activities	*
TOTAL	92.2

Notes: * Less than $50 million.
** The separate natural resource revenue sources have been aggregated.

Source: Department of Finance, Canada: Provincial Fiscal Equalization, Second Estimate, 1987-88 (July, 1987).

This set of revenue sources is known as the Representative Tax System (RTS), since it attempts to take into consideration what provinces as a whole actually tax. Each of the revenue sources has an associated tax base. For example, the base for revenues from the sale of beer is the volume of beer sold.

The tax bases have been modified over the years. Discussions continue on technical problems that are perceived to remain in the determination of appropriate components to use in some tax bases to satisfy the requirement of making them "representative". For example, there is currently a debate on the property tax base: since there is no comparable interprovincial property tax base, the equalization formula has had to rely on proxies for the assessed values of land and buildings.

For each revenue source, a national average tax rate is calculated by dividing the total revenues to be equalized by the total all-province tax base.

Comparisons can be made among provinces by applying the national average tax rate for each revenue source to individual provincial tax base values on a per capita basis.

The equal yield per capita standard that the equalization formula sets must then be determined.

The current benchmark that is applied to each province for each revenue source is termed the "five-province standard"; this standard is derived by applying the national average tax rate to the tax bases of Quebec, Ontario, Manitoba, Saskatchewan and British Columbia and calculating the per capita yield for the five provinces.

Finally, the difference between this standard per capita yield and a province's own per capita yield provides its relative per capita deficiency or surplus for each of the 37 sources.

Two examples illustrate this process:

- In calculating the latest estimate for 1987-88 national average tax rates, the Newfoundland personal income tax base yields $525.71 per capita. The national average tax rate applied to the five-province standard tax base yields $1,033.45 per capita. This means that Newfoundland has a personal income tax deficiency of $507.74 per capita ($1,033.45 - 525.71). Newfoundland's equalization component in respect of personal income tax, $289 million, is then calculated by multiplying its per capita deficiency by its population.
- Conversely, Ontario's yield at the national average tax rate is $1,198.44 per capita. Since this yield is above the $1,033.45 per capita that results from applying the national average tax rate to the five-province standard, Ontario has a personal income tax surplus of $164.99 per capita.

The calculation of a deficiency for a province for a particular revenue source does not necessarily mean that the province will receive equalization payments. The size of equalization entitlements is determined by the netting of all negative and positive entitlements. In Ontario's case, for example, although the formula indicates a deficiency in the oil and gas revenue sources, negative entitlements in other sources are sufficiently large to negate entitlement to equalization on an aggregate basis.

The current "five-province standard" replaced a national average standard in 1982. This change, combined with a number of tax base modifications, tended to disadvantage Quebec and Manitoba. Accordingly, a three-year transitional guarantee was incorporated into the formula.

The transitional guarantee provided that no province could receive less under the new formula than it received in the last year of the old formula. Provision was made for a specified amount of growth.

This provision lapsed at the end of the 1984-85 fiscal year, at an estimated three-year cost to the federal government of $2.1 billion. All equalization recipients received transitional guarantee payments.

As shown in Table 9, following the lapse of the transitional program, additional supplementary equalization payments totalling $220 million were made to the six recipient provinces in respect of the 1985-86 fiscal year. One year later, Manitoba received an additional $65 million in supplementary equalization.

Supplementary Equalization Payments ($ Million) — **Table 9**

	1985-86	1986-87
Newfoundland	15	–
Prince Edward Island	5	–
Nova Scotia	20	–
New Brunswick	20	–
Quebec	110	–
Manitoba	50	65
TOTAL	220	65

Source: Department of Finance, Canada.

The sole legislative constraint on the growth of equalization entitlements is that aggregate transfers must not exceed the year-over-year increase in Gross National Product (GNP). So far, this ceiling has not had to be applied.

For 1987-88, the current estimate of equalization entitlements is $5.9 billion. Although Quebec receives the greatest share of total equalization, on a per capita basis it receives the second least. Table 10 shows the breakdown of the estimated 1987-88 entitlements among the provinces as well as the entitlements on a per capita basis.

Estimated Equalization Entitlements by Province, 1987-88 — **Table 10**

	($ Million)	($ Per Capita)
Newfoundland	754	1,322
Prince Edward Island	156	1,221
Nova Scotia	681	776
New Brunswick	699	977
Quebec	2,983	453
Manitoba	506	469
Saskatchewan	153	150
TOTAL	5,931	540

Note: Ontario, Alberta and British Columbia have net negative entitlements and do not receive equalization payments.

Source: Department of Finance,Canada: Provincial Fiscal Equalization, Second Estimate, 1987-88 (July, 1987).

Fiscal Stabilization

In order to protect provinces from sudden year-over-year losses in revenue resulting from an economic downturn, the federal government has provided for fiscal stabilization payments. These unconditional cash transfers ensure that each province's tax revenues, measured on the basis of constant tax rates and structure, plus its equalization payments, will not be less than they were in the previous year.

In 1987-88, the federal government introduced, among other technical changes, an annual ceiling of $60 per capita for grant assistance. Entitlements exceeding this limit will be provided as interest-free loans repayable within five years.

To date, only one province has received payments under this program -- British Columbia received $175 million in respect of the 1982-83 fiscal year. However, fiscal stabilization payments provide an important guarantee for many provinces when their credit ratings are under review.

Personal Income Tax Revenue Guarantee

Provincial Personal Income Tax Revenue Guarantee payments ensure that provinces will not suffer a reduction in personal income tax revenues due to amendments to the federal Income Tax Act. Should federal actions reduce a province's personal income tax revenues by more than 1.0 per cent from the preceding year, that province becomes eligible for a federal revenue guarantee payment. The amount of the payment would be the difference, exceeding 1.0 per cent, between the amount of tax which would have been raised under the federal legislation prior to amendment and the amount raised subsequent to amendment.

Canada Assistance Plan

The Canada Assistance Plan (CAP) was established by federal legislation in 1966 as a cost-sharing mechanism for provincially-administered social assistance and welfare programs. The Canada Assistance Plan replaced the targetted shared-cost programs which provided assistance for the elderly, the blind, the disabled and the unemployed. By the end of the 1960s, these programs had come under increasing criticism for their eligibility restrictions. The new program was designed to bring a measure of order and coherence to fragmented provincial public assistance systems.

Since its inception, payments under the Canada Assistance Plan have grown dramatically, increasing from $343 million in 1967-68 to an estimated $4.2 billion in 1987-88. This makes the Canada Assistance Plan the third largest source of transfers to the provinces after Established Programs Financing and equalization. In Ontario alone, Canada Assistance Plan payments are expected to exceed $1.2 billion for 1987-88.

The Canada Assistance Plan is intended to act as a last resort safety net. Under its provisions, the federal government contributes an amount equal to 50 per cent of provincial expenditures on assistance payments (food, shelter and clothing) to individuals in need, and a range of welfare services,

including child welfare, day care, homemaker services for the elderly, institutions for the disabled and family counselling. To qualify for federal Canada Assistance Plan funds, provincial programs must be designed to benefit those "in need or likely to become in need". As well, potential beneficiaries must demonstrate their eligibility through either a needs test or an income test, as determined by each province and subject to federal guidelines.

Although the Canada Assistance Plan stands out as a highly successful example of federal-provincial co-operation, the program has been the subject of numerous reviews during the last two decades. In 1970-71, the Senate Committee on Poverty issued a report that was critical of the Canada Assistance Plan and recommended that it be replaced by a guaranteed annual income. Ten years later, negotiations were underway to remove social services from the Canada Assistance Plan and provide them through a block fund under a proposed Social Services Financing Act modelled on Established Programs Financing. The proposal, however, was withdrawn when the provinces refused to accept a reduction in the Established Programs Financing escalator to GNP growth less one per cent. The proposal to replace the federal share of the Canada Assistance Plan and other federal tax and transfer programs, such as family allowances and child tax credits, with a guaranteed annual income, was resurrected by the Macdonald Commission in 1985 when it recommended the adoption of a Universal Income Security Program.

More recently, the Nielsen Task Force on Program Review found no support for a major revision of the Canada Assistance Plan. However, its report did register concern over the trend toward long-term dependence on assistance among "employables" and warned of the danger that future Canada Assistance Plan costs may become unaffordable as a result. The Nielsen review concluded that it may be necessary to change the open-ended nature of Canada Assistance Plan funding by limiting federal spending under the agreement. Increasingly, the limits inherent in the Canada Assistance Plan's welfare orientation are becoming more evident as priorities in the areas of child care and family violence are pushed to the foreground.

Provincial-Local Transfers

In 1987-88, the province will provide \$3.9 billion in financial support to municipalities and municipal agencies, as indicated in Table 11.

Provincial support to school boards amounts to more than \$3.8 billion, including nearly \$150 million in capital assistance.

Highlights of Provincial Transfers to Local Governments — **Table 11**

($ Million)

	Outlook 1987-88
Transfers to Municipalities	
Unconditional	824
Roads	601
Transit	311
Social Services	1,251
Health	175
Environmental	136
Recreational & Cultural	86
Other	406
Ontario Municipal Improvement Fund	60
Total Municipal Transfers	3,850
Transfers to School Boards	
General Legislative Grants	3,609
Capital Grants	147
Total School Transfers	3,756
Total Transfers to Local Government	7,606

Source: Ontario Ministry of Treasury and Economics.

Transfers to Municipalities

Transfer payments to municipalities are estimated to increase by 10.9 per cent in 1987-88.

The average annual growth in Provincial support to the municipal sector has outpaced inflation since the beginning of the decade. As Table 12 indicates, total operating transfers increased faster than the rate of inflation, while the growth in capital transfers was lower than inflation, reflecting the fairly stable pattern of provincial capital activity in general.

Provincial Transfers to Municipalities **Table 12**
($ Million)

	1982-83	Outlook 1987-88	Average Annual Increase (%)
Unconditional	627	824	5.6
Conditional	1,146	1,934	11.0
Total Operating	1,773	2,758	9.2
Capital	898	1,032	2.8
Total Transfers	2,671	3,790	7.3
Ontario Municipal Improvement Fund	–	60	–
Enriched Total Transfers	2,671	3,850	7.6

Source: Ontario Ministry of Treasury and Economics.

Municipal Sector Performance

Municipal spending in 1987 is expected to grow by 8.8 per cent. This growth continues to be led by the areas served by regional governments, excluding Metro Toronto, which account for 39 per cent of municipal spending. These areas are generally experiencing above-average service growth as measured by the growth in households. It should also be noted that individual municipal patterns of growth within these areas can vary considerably. By comparison, Table 13 shows that for the rest of the province spending growth is expected to average around 7.8 per cent.

Estimated Municipal Spending, 1986 & 1987 **Table 13**
($ Million)

	1986	1987	Increase (%)
Metropolitan Toronto	3,404	3,687	8.3
Other Regional Governments	3,974	4,385	10.3
All Regional Governments	7,378	8,072	9.4
Cities Not Part of Regional Governments	1,471	1,567	6.5
All Other Municipalities	1,575	1,697	7.8
Non-Regional Governments	3,046	3,264	7.2
Total Municipal Sector	10,424	11,336	8.8

Source: Ontario Ministry of Municipal Affairs.

Since 1982, provincial transfers have almost kept pace with the growth in overall local spending. As shown in Table 14, the proportion of municipal financing accounted for by transfers has dropped slightly over the period, with the difference being made up by municipal property taxes.

Municipal Revenue Mix (Per Cent) — **Table 14**

	1982	1987
Property Taxation	34.8	36.7
Provincial Grants	31.8	30.0
All Other Revenues	33.3	33.3
	100.0*	100.0

* Totals may not add due to rounding

Source: Ontario Ministry of Municipal Affairs.

Since 1970, property tax burdens (taxes in relation to household incomes) have remained below the 3.0 per cent level, and are now approximately 2.4 per cent. However, over the past five years, overall mill rate increases (including school taxes) have outpaced the growth in both inflation and incomes. School taxes have contributed more to the recent rise in local taxation, growing 8.3 per cent for an average household on an annual basis since 1982, compared to 6.9 per cent annual growth in municipal taxes.

Education Finance

The funding of elementary and secondary education in Ontario is shared between the province and local school boards. The provincial share is distributed to school boards through the General Legislative Grants with the school board share being raised from local property taxes. School funding is a significant component of government spending at both levels, as shown in Table 15.

Education Finance in Perspective (Per Cent) — **Table 15**

	1987-88
Transfer Payments to School Boards	
Relative to Total Local Transfers	49.4
Relative to Provincial Budgetary Expenditure	10.8
School Finance in the Local Sector	
School Board Operating Spending Relative to Total Local Operating Spending	46.4
School Taxes Relative to Total Local Property Taxes	50.9

Source: Ontario Ministry of Treasury and Economics.

Appendices

GLOSSARY OF TERMS

Ad Valorem Tax - A percentage-based tax, typically applied to a measure of value such as selling price.

Basic Federal Tax - The level of tax determined by applying the federal tax rate schedule to taxable income. It is not federal tax payable, which is basic tax adjusted by credits, surtaxes or reductions. Ontario's tax rate of 50 per cent is applied to Basic Federal Tax to yield Basic Ontario Income Tax.

Budgetary Revenue - Includes revenue raised through taxation, premiums, fees, licenses and permits, payments from the federal government under fiscal arrangements and shared-cost programs, and income from investments.

Canada Assistance Plan - Federal-provincial cost-sharing mechanism for provincially-administered social assistance and welfare programs.

Capacity Utilization Rate - The actual output of an industry as a percentage of the output it could produce with its existing plant, equipment and work force.

Consolidated Public Sector Funded Debt - Funded debt incurred at all levels of Provincial jurisdiction including the Province, Ontario Hydro, municipalities, hospitals, universities and colleges.

Consumer Price Index - A monthly index measuring the retail prices of a fixed basket of goods and services purchased by consumers.

Consumption - The value of spending by consumers on goods and services, measured in current dollar terms (nominal) or adjusted for inflation (real). Consumption accounts for approximately 60 per cent of Gross National Product.

Cost-of-living Adjustment - An adjustment to incomes, wages or other payments to maintain previous purchasing power in the face of changing consumer prices.

Debt to Equity Ratio - The total debt of industrial corporations divided by total shareholders' equity.

Deductions - Reductions in the tax base, usually for specific expenses incurred in order to earn income.

Economies of Scale - Reductions in the average cost of production achieved by increasing the volume of output.

Equalization - Unconditional transfers from the federal government to qualifying provinces with the purpose of ensuring that provincial governments have sufficient revenues to provide reasonably comparable levels of public service at reasonably comparable levels of taxation.

Established Programs Financing - Unconditional federal payments to the provinces in respect of health care and post-secondary education.

Exemptions - Amounts deductible from income in recognition of specific personal circumstances.

Expenditures - Expenditures on government programs include payments for goods and services, interest on the public debt, salaries, transfer payments to individuals, municipalities and institutions, subsidies and grants, the acquisition and creation of fixed assets, and the lending, investment and trust administration activities of the Government.

Export - A good or service which is produced in one country or jurisdiction and sold to another.

Final Demand - Purchases of goods and services within the economy, excluding inventory change.

Final Domestic Demand - Purchases of goods and services within the economy, excluding the foreign sector (exports and imports) and inventory change.

Fiscal Arrangements - Institutional vehicles through which the federal government transfers funds to the provinces as part of its commitment to shared-cost programs and interprovincial fiscal capacity equalization.

Fiscal Capacity - Measure of a province's relative ability to raise revenues from available revenue sources.

Fiscal Policy - The use of the Government's spending and taxing power to regulate the aggregate level of economic activity. Expansionary fiscal policy is generally characterized by an increase in discretionary spending or a tax cut.

Fiscal Stabilization - Unconditional cash transfers from the federal government to ensure that no province's tax revenues, measured on the basis of constant tax rates and structure, plus its equalization payments, will be less than they were in the previous year.

Funded Debt - Debt which has a specified term to maturity and is secured by a debt instrument such as a bond.

Gramm-Rudman - A deficit-trimming formula proposed by U.S. Senators Gramm and Rudman which establishes a schedule of annual deficit reduction targets culminating in a balanced federal budget by 1990. If these targets are not met, the President would be required to achieve them through automatic reductions in most categories of federal government expenditures.

Gross Borrowing - Total borrowing including borrowing necessary for debt retirement purposes.

Gross Domestic Product (GDP) - The value of goods and services produced within the geographic boundaries of an area.

Gross National Product (GNP) - A nation's total output of goods and services, expressed either in current dollar value (nominal) or adjusted for

inflation (real). The percentage change in real GNP is the usual measure of the real growth rate of the economy.

Gross Provincial Product (GPP) - The value of goods and services produced within the geographic boundaries of a province; may be measured in current dollar terms (nominal) or adjusted for inflation (real).

Guaranteed Debt - Debt for which the Province agrees to meet the costs if the borrowing party can not; primarily, for Ontario Hydro.

Household Formation - Net increases in new households in a period.

Import - A good or service which has been bought from another country or jurisdiction.

Inflation - A continuing rise in the general price level.

Interest Rate - The price paid (charged) by a borrower (lender) of money. Nominal interest rates are those actually paid; real interest rates are nominal rates less the expected rate of inflation (current rates of inflation are generally used as proxies for expected rates).

Interest Service Ratio - Total interest payments taken as a per cent of cash flow of industrial corporations before interest and taxes are deducted.

Inventory - The various raw materials, parts and finished goods plus work-in-progress of a firm, and their total value.

Inventory Accumulation - An increase in the level of inventories held in the economy.

Investment - The value of spending on capital goods such as houses, plant and machinery and equipment; may be measured in current dollar terms (nominal) or adjusted for inflation (real).

Labour Force - The total number of persons, age 15 and over, who are either employed or looking for work.

Marginal Tax Rates - A schedule of rates used to determine the amount of tax payable at various taxable income levels and on each additional dollar of taxable income.

Monetary Policy - The policies of the central bank (Canada - Bank of Canada; U.S. - Federal Reserve Board) that determine the availability and cost of capital (i.e., interest rates) in the economy. Tight (anti-inflationary) monetary policy restricts growth of the money supply, thus raising interest rates and reducing inflation by squeezing demand from the economy.

Multi-Stage Sales Tax - a percentage-based tax which applies to the difference between the taxable sales and taxable purchased inputs for each transaction of the production and distribution process, such that only the value added is taxed at each stage.

Net Borrowing - Gross borrowing less borrowing needed for debt retirements.

Net Cash Requirements (NCR) - The difference between total revenue inflows to and total expenditure outflows from the Consolidated Revenue Fund.

Nominal (GNP, consumption, etc.) - In current dollars; not adjusted for inflation.

Non-Budgetary Revenue - Is the inflow of funds into the Consolidated Revenue Fund as a result of repayment of loans, deposits into pension and related benefit accounts and payments into special purpose accounts such as P.O.S.O and other trust accounts.

Non-Marketable Securities - Securities which may not be bought or sold in public capital markets.

Non-Public Borrowing - Borrowing from non-public sources of funds, usually pension funds like the Canada Pension Plan.

OECD Countries, Major - Canada, France, Italy, Japan, United Kingdom, United States, West Germany.

Operating Position - The difference between total current revenues and total current expenditures excluding capital expenditures.

Organization for Economic Cooperation and Development (OECD) - An organization of industrial nations, with a permanent staff of officials, established in 1961 to improve trade and investment flows among its members, to help analyze and deal with balance-of-payments and other economic problems and to coordinate foreign-aid policies.

Other Budgetary Revenue - Equals total budgetary revenue minus taxation revenue and payments from the federal government. Major sources include OHIP premiums, LCBO and Lottery profits, fees and licenses and interest income.

Own-Purpose Debt - Debt issued by Ontario for Provincial use only. This excludes debt issued by Ontario on behalf of Ontario Hydro.

Paid-Up Capital - For most corporations, paid-up capital funds invested in the corporation by its shareholders and other parties, loans or advances made to the corporation, and its cumulative undistributed corporate profit less its investment in other firms.

Participation Rate - The percentage of the population age 15 and over that is in the labour force.

Payroll Tax - An employment income-based tax, usually a percentage, which may be levied on the employer, employee or on both.

Per Point Yields - An estimate of direct revenue which would be gained or lost for a first unit change in relation to a specified change in tax rates.

Personal Disposable Income - The income remaining to persons for consumption or saving after deduction of income taxes, other personal direct taxes, CPP premiums, etc.

Personal Income - The income received by persons from all possible sources.

Personal Income Tax Revenue Guarantee - Federal program to ensure that amendments to the federal Income Tax Act will not reduce a province's personal income tax revenues by more than one per cent

Personal Savings Rate - Percentage of personal disposable income that is not spent for current consumption.

Prime Rate - The interest rate charged by chartered banks to their most credit-worthy customers.

Productivity - Output per unit of input (labour, capital, energy) employed.

Protectionism - Advocacy of protective tariffs and other barriers to trade as a means of developing national wealth.

Public Borrowing - Borrowing which is done through public capital markets.

Public Debt Interest - Interest paid by Ontario on total debt incurred for its own purpose.

Real (GNP, consumption, etc.) - Adjusted for inflation, constant dollars.

Real Domestic Product (RDP) -Gross domestic product adjusted for inflation.

Recession - A downturn in the business cycle characterized by weak economic activity and high unemployment. Two consecutive quarters of decline are generally considered to indicate a recession.

Recovery - The upturn of the business cycle characterized by an increase in economic activity.

Representative Tax System - A series of thirty-seven distinct revenue sources used to determine what provinces, collectively, tax.

Revenue - Includes revenue raised through taxation, premiums, fees, licences and permits, payments from the Federal Government under the Fiscal Arrangements and shared-cost programs and income from investments and earnings from advances and investments to public sector bodies.

Seasonal Adjustment (seasonally-adjusted) - A statistical adjustment to take account of seasonal factors, such as weather, so that data more accurately reflect underlying trends.

Specific Rate of Tax - A fixed rate per unit, (e.g. cigarettes will be taxed at the rate of 2.7 cent each).

Surtax - A tax additional to basic Ontario or basic federal tax, usually calculated with reference to basic tax or to taxable income.

Tariff - A tax imposed on imported goods, levied either as a percentage of their value or according to the number of units imported.

Tax Base - The taxable value to which tax rates are applied; (e.g. the taxable portion of income; or the value of goods and services taxed under the retail sales tax).

Tax Collection Agreement - The agreement between each province and the federal government that authorizes the federal government to collect that province's personal income tax. Under the current arrangements the provinces agree to calculate their tax as a percentage of basic federal tax, effectively waiving all rights to determine the tax base. Provinces are permitted limited credit and surtax/reduction programs. Some provinces have similar arrangements for corporate income taxes.

Tax Credit - A reduction of certain taxes paid, with the amount of the credit determined by a specified formula. The Ontario Tax Credits, for example, offset property and sales taxes for individuals by reducing Ontario personal income taxes. The level of this credit is a function of both the amount of tax paid and the ability to pay of the individual. As a result, credit benefits fall as income rises - effectively redistributing tax burdens in favour of lowest income individuals.

Tax Effort - Measure of the relative extent that a province actually taxes available revenue sources.

Total Debt - Funded and unfunded debt borrowed for the Province.

Unemployment Rate - The number of persons in the labour market who are unemployed, as a percentage of the labour force. The seasonally unadjusted rate is referred to by Statistics Canada as the "actual" unemployment rate.

Unfunded Debt - Debt which is not secured by a debt instrument such as deposits with the Province of Ontario Savings office.

Unit Labour Cost - A measure of productivity calculated by dividing the total wage bill by the total number of units of a good or service produced.

Value-Added - The value of a firm's output minus the value of the inputs it purchases from other firms.

Ten-Year Review of Selected Financial and Economic Statistics
($ million)

	1978-79	1979-80	1980-81	1981-82
Financial Transactions				
Revenue	13,233	15,246	16,470	18,886
Expenditure	14,413	15,830	17,273	20,389
Net Cash Requirements	1,180	584	803	1,503
Financial Position				
Total Debt	16,467	18,097	19,512	21,354
Funded Debt[1] (excluding Ontario Hydro)	14,038	15,196	16,215	17,592
Provincial Debt Transactions (net)	1,652	1,132	968	1,363
Gross Domestic Product (GDP) at Market Prices[2]	92,408	104,367	114,992	131,831
Personal Income[2]	75,832	84,607	94,407	110,028
Population - June ('000)	8,440	8,501	8,570	8,625
Funded Debt per Capita (dollars)	1,663	1,788	1,892	2,040
Personal Income per Capita (dollars)	8,985	9,953	11,016	12,757
Total Expenditure as a per cent of GDP	15.6	15.2	15.0	15.5
Net Cash Requirements as a per cent of GDP	1.3	0.6	0.7	1.1
Total Debt as a per cent of GDP	17.8	17.3	17.0	16.2
Funded Debt as a per cent of GDP	15.2	14.6	14.1	13.3
Cumulative Net Borrowing for Ontario Hydro				
U.S.	4,141	4,506	4,379	5,573
C.P.P.	–	–	500	1,000
Contingent Liabilities (mainly Ontario Hydro)	7,096	7,904	8,553	9,284

1 Funded Debt includes debentures, notes and Treasury Bills.

2. Gross Domestic Product and Personal Income are calculated on a calendar year basis. The amounts appearing in a fiscal year column are for the preceding calendar year.

3 Ontario Finances, September 30, 1987

Note: All funds are quoted in Canadian dollars.

* Before extraordinary adjustments.

** After extraordinary adjustments.

N/A - not available.

Source: Ontario Ministry of Treasury and Economics

Table C8

1982-83	1983-84	1984-85	1985-86*	1985-86**	1986-87	Interim[3] 1987-88
20,433	22,647	25,196	27,692	30,858	31,223	34,221
22,911	24,936	26,898	29,297	32,968	32,571	35,194
2,478	2,289	1,702	1,605	2,110	1,348	973
23,955	27,406	30,041	32,904	32,904	35,103	36,968
19,643	22,503	24,593	26,695	26,695	27,921	28,827
2,051	2,860	2,090	2,102	2,102	1,194	906
137,098	151,790	170,993	185,530	185,530	202,076	220,142
122,341	131,952	146,067	158,990	158,990	171,608	184,800
8,702	8,798	8,901	9,010	9,010	9,114	9,207
2,257	2,558	2,763	2,963	2,963	3,064	3,131
14,059	14,998	16,410	17,646	17,646	18,829	20,072
16.7	16.4	15.7	15.8	17.8	16.1	16.0
1.8	1.5	1.0	0.9	1.1	0.7	0.4
17.5	18.1	17.6	17.7	17.7	17.4	16.8
14.3	14.8	14.4	14.4	14.4	13.8	13.1
6,058	6,487	7,206	7,189	7,189	6,667	N/A
1,000	1,000	1,000	1,000	1,000	1,119	N/A
11,122	12,711	14,220	15,963	15,963	17,603	N/A

Economic Outlook and Fiscal Review

ONTARIO 1988

Ontario

Ministry of
Treasury and
Economics

Economic Outlook and Fiscal Review

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Treasury and
Economics

December 1988

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Preface

In Spring 1986, the Legislature set up the Standing Committee on Finance and Economic Affairs to "consider and report to the House its observations on the fiscal and economic policies of the Province." The 1988 Economic Outlook and Fiscal Review is part of the Government's efforts to assist the Committee in its endeavours and to enhance the general process of public consultation leading to the development of the 1989 Ontario Budget.

The Ontario Economic Outlook

Ontario Economic Outlook at a Glance			
	1987	1988	1989
Real Growth (%)	4.4	4.5	2.9
Inflation (%)	5.1	4.7	5.1
Job Creation (000s)	151	180	105
Unemployment Rate (%)	6.1	5.0	5.0

Ontario is entering its seventh consecutive year of economic growth.

Driven largely by business investment, the economy should continue to expand in 1989. The rate of growth will be more moderate and sustainable, with real Gross Domestic Product increasing by 2.9 per cent. Smaller employment gains and a stable savings rate will restrain spending growth compared to the last few years.

The economy will nevertheless generate over 100,000 new jobs in 1989. Unemployment will average 5.0 per cent -- unchanged from 1988, and the lowest level since 1974.

Inflation will remain stable, rising only slightly to 5.1 per cent.

Ontario Economic Outlook: Towards Sustainable Growth

Recent Performance: Growth Continues

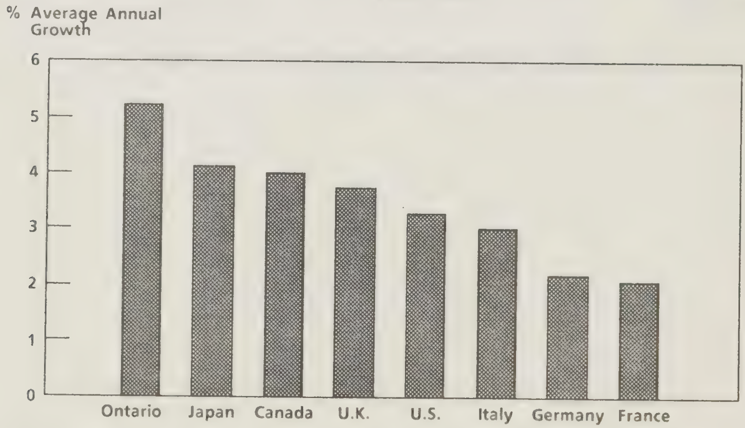
The current economic expansion has continued without interruption for 24 quarters. It is now the second longest expansion since 1950, surpassed only by the 52-quarter period of growth between 1961 and 1973. Over the past six years, real output in Ontario has expanded by 42 per cent. Employment has increased by 860,000 jobs.

Ontario emerged from the 1981-82 recession with substantial unemployed labour and plant capacity, significant pent-up demand for consumer durables and housing and a high level of savings. These factors have made possible the rapid growth in output and employment to this point in the expansion.

Spare capacity has now been absorbed and the savings rate has declined to its lowest level since 1971. As a result, a transition to more moderate and sustainable growth is underway.

Ontario had fully recovered from the recession by 1984. Since 1985, real output in Ontario has grown by an average 5.2 per cent a year, and employment has increased by 3.6 per cent annually. In both output and employment terms, Ontario has experienced higher growth than any of the major industrialized countries.

INTERNATIONAL COMPARISON OF REAL OUTPUT GROWTH
1985-1988



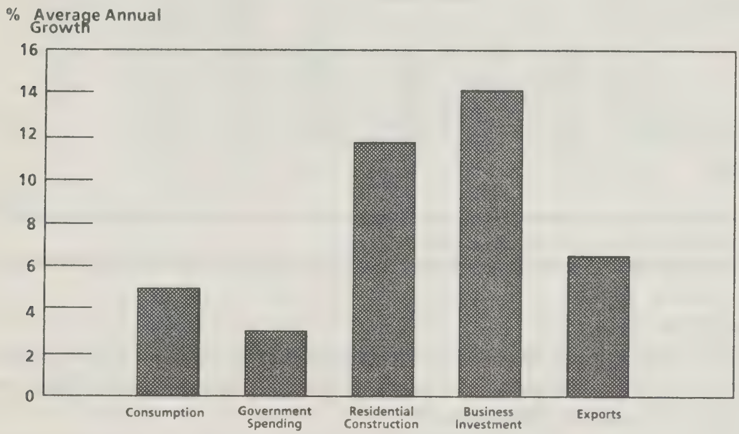
Source: International Monetary Fund, Statistics Canada and Ontario Ministry of Treasury and Economics.

During the 1983-1984 period, consumer spending and exports were the fastest growing components of aggregate demand. By contrast, in the 1985-1988 period, the expansion was led primarily by residential construction and business investment in plant and equipment. The strength of the expansion was based on a number of developments. These included growth in personal income and corporate profits, healthy growth abroad, lower oil prices, stable interest and inflation rates and an exchange rate that enhanced international competitiveness.

Real business investment grew at an average annual rate of 14.2 per cent over the 1985-1988 period, reflecting plant expansion to satisfy increased foreign and domestic demand and plant modernization to meet international competition.

An estimated 300,000 homes were built in Ontario over the four-year period 1985 to 1988. Sales of these homes were supported by pent-up demand from the early 1980s, high levels of net interprovincial and international migration, and a decline in mortgage interest rates.

SOURCES OF REAL GROWTH IN ONTARIO
1985-1988



Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

The Ontario economy has continued to expand in 1988. By the end of this year, the economy will have created a record 180,000 additional jobs. The average unemployment rate in 1988 is estimated at 5.0 per cent, down more than a full percentage point from 1987.

In recent years, growth in Ontario has outpaced that in the rest of Canada; in 1988, however, growth in the country has become more balanced.

- In 1986 and 1987, Ontario's real output expanded at an average annual rate of 5.4 per cent, compared to 2.4 per cent for the rest of Canada.
- In 1988, real output growth in Ontario will be an estimated 4.5 per cent, compared to 4.1 per cent for the rest of the country.

Key Assumptions: 1989

International and interprovincial exports account for almost half of the provincial GDP. The Ontario economy is therefore highly sensitive to growth in its major export markets. Energy prices and financial markets also have an important bearing on the outlook.

Ontario's Export Markets, 1987 — **Table 1**

	Share of Ontario GDP	
United States	28.4	
EEC	1.4	
Japan	0.4	
Other	1.9	
Total International		32.1
Rest of Canada		15.4
Total		47.5

Source: Ontario Ministry of Treasury and Economics.

The International Outlook

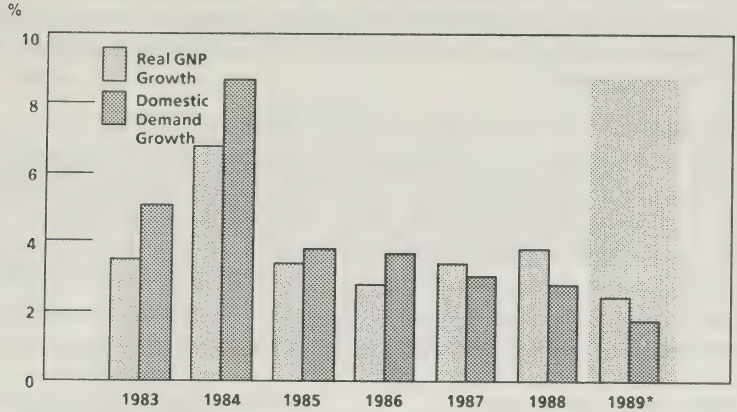
According to International Monetary Fund projections, real output in the Group of Seven industrialized nations will expand by over 4.0 per cent in 1988, surpassing last year's growth rate of 3.2 per cent.

In the U.S., real GNP will post its strongest performance since 1984, based on buoyant exports and machinery and equipment spending. Strong growth in 1988 has reduced unemployment to its lowest level in fourteen years and strained plant capacity. Capacity utilization has risen to 84 per cent -- the highest level since the late 1970s. Higher import prices and the drought have also contributed to cost pressures.

Inflation fears have prompted the Federal Reserve Board to raise interest rates by one and a half percentage points since the spring. The restrictive stance in monetary policy is expected to continue and to restrain inflationary pressures by slowing down economic expansion next year. Weak oil prices should also restrain inflation.

In 1989, the rate of growth of U.S. real GNP will decline to a projected 2.4 per cent from 3.9 per cent in 1988. Consumer price inflation will creep upwards from about 4.0 per cent in 1988 to just under 5.0 per cent in 1989.

U.S. ECONOMIC PERFORMANCE AND PROSPECTS
1983-1989



* Forecast.
Source: U.S. Department of Commerce and Ontario Ministry of Treasury and Economics.

Despite the relatively strong growth of the past year, considerable uncertainty characterizes the short-term U.S. outlook. The trade deficit remains unsustainably high. It is estimated to be $140 billion (U.S.) in 1988, down from $170 billion in 1987. Nonetheless, this continued high level, coupled with increased outflows of interest payments, raises the prospect of further depreciation of the dollar. The federal budget deficit represents another difficult challenge for the new President; negotiations with Congress will be crucial in setting the direction of fiscal policy. The Administration will have to deal effectively with these twin challenges in order to maintain confidence in the dollar and stability in interest rates.

The outlook for other major industrialized countries is also one of moderating economic growth in 1989. The International Monetary Fund projects that real GDP in the four largest economies of Western Europe will expand by 2.3 per cent on average, after this year's 3.2 per cent advance. Japan's economy is expected to grow by 4.2 per cent, based on strong domestic demand, following a 5.8 per cent rise this year.

Rest of Canada

Growth in the rest of Canada in 1989 is expected to make a modest contribution to Ontario's export position, with strength in Quebec and the Atlantic provinces offsetting weakness in Western Canada.

Continuing strength in markets for seafood products and the start of construction on several major projects should enable the Atlantic provinces to grow faster than the national average.

In Quebec, which accounts for the largest proportion of Ontario's interprovincial exports, non-residential construction activity, led by Hydro Quebec's James Bay II power project, will sustain growth in 1989.

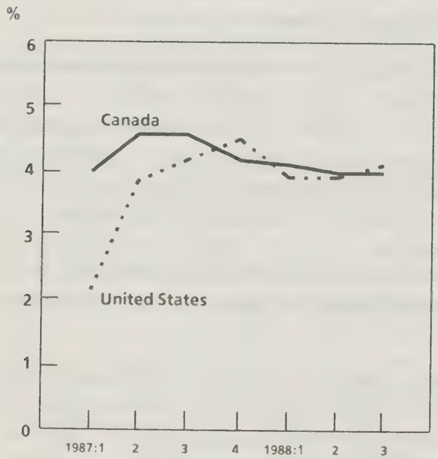
Manitoba and Saskatchewan are expected to record higher growth rates in 1989 as farm output rebounds, following the 1988 drought.

Uncertainty about oil prices is expected to dampen the pace of economic activity in Alberta. Weakness in the U.S. housing market will constrain growth in British Columbia's lumber industry.

Financial Markets

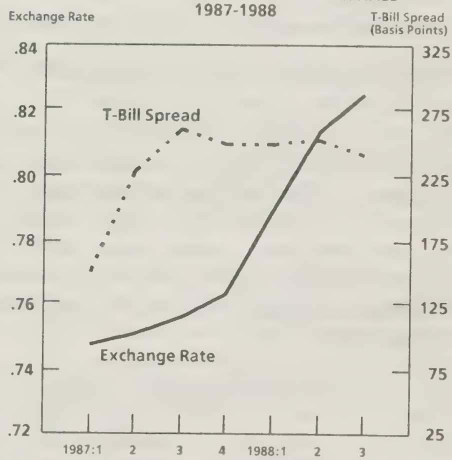
Over the past two years, inflation rates in Canada and the United States have converged. The Bank of Canada has, nevertheless, maintained a wide differential between Canadian and U.S. short-term interest rates. As a result, the real interest rate spread has increased sharply. This has led to a rapid appreciation in the value of the Canadian dollar relative to its U.S. counterpart. In addition, the apparent determination of the Bank of Canada to pursue its anti-inflation objective has reinforced upward pressure on the Canadian dollar.

CANADA AND U.S. CPI INFLATION
1987-1988



Source: Statistics Canada and U.S. Department of Labor.

CANADA-U.S. EXCHANGE RATE AND CANADA-U.S. 3-MONTH TREASURY BILL DIFFERENTIALS
1987-1988



Source: Bank of Canada.

Interest rates in both Canada and the United States are expected to rise by one-half to one percentage point during the first half of 1989. However, as the pace of economic activity slows later in the year, rates are expected to begin to decline.

The recent convergence of Canada-U.S. inflation rates and the rise in the Canadian dollar indicate clearly that there is room for a narrowing of the Canada-U.S. short-term interest rate differential. The forecast assumes that the Bank of Canada will allow the interest differential to narrow somewhat in 1989. The average value of the dollar is expected to remain in the 80 to 83 cent (U.S.) range. (See pages 26-28 for a discussion of the adverse competitive impacts of exchange appreciation.)

Energy Prices

For 1988, the province's import bill for oil and natural gas will be an estimated $5.8 billion, 13 per cent lower than in 1987. This drop is principally the result of a modest reduction in international oil prices and an increase in the value of the Canadian dollar.

The outlook for oil prices depends to a considerable degree on developments within OPEC and in the Middle East. In recent months, a number of OPEC members have exceeded their production quotas and oil prices have fallen. Although the prospect of even lower oil prices and lower oil revenues should act as a unifying force within OPEC in 1989, fundamental disagreements within the cartel could lead to continued price weakness.

On the demand side, while the major industrial economies will continue to grow, the associated growth in crude oil demand will be modest and will not have a major influence on crude prices.

On balance, delivered oil prices are expected to fall within the U.S. $15-$17 per barrel range in 1989, down from about U.S. $18.31 in 1987 and U.S. $16.00 in 1988.

Sources of Growth in 1989: Investment Leads the Way

Business investment will be the strongest source of economic growth in 1989. Growth in other components of domestic demand will moderate, most notably consumer spending and housing.

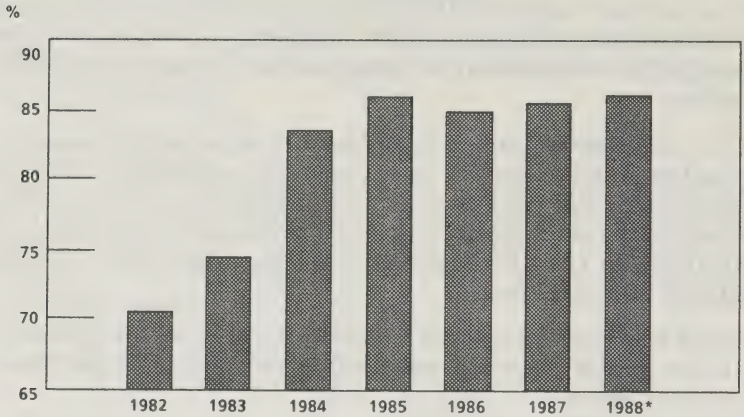
Business Investment

Investment in plant and equipment continued to be strong in 1988. Further increases are expected next year, although at a slower pace. Strength in business investment is the result of healthy corporate profits, high rates of capacity utilization, continued sales growth and the introduction of new technologies.

Corporate profits in Ontario are expected to grow by 9.6 per cent in 1989, following an estimated 17.0 per cent rise in 1988. Robust growth in the Canadian economy, strengthening commodity prices and continued cost-cutting measures have all contributed to strong profit growth.

As a result of steady increases in industrial production, capacity utilization rates have risen sharply since the recession of 1981-82. Further increases in sales will spur more investment as businesses move to eliminate production bottlenecks.

CAPACITY UTILIZATION RATES IN CANADIAN MANUFACTURING
1982 - 1988



* First two quarters.
Source: Bank of Canada.

- The overall capacity utilization rate for total non-farm goods-producing industries in Canada climbed from a low of 69.3 per cent in the last quarter of 1982 to 86.5 per cent in the second quarter of this year.

- Manufacturing industries experiencing capacity utilization rates in excess of 90 per cent include food and beverages, rubber and plastic products, textiles, furniture, primary metals, fabricated metals, electrical and electronic products and non-metallic mineral products. The mining, utilities and energy industries also have capacity utilization rates above 90 per cent.

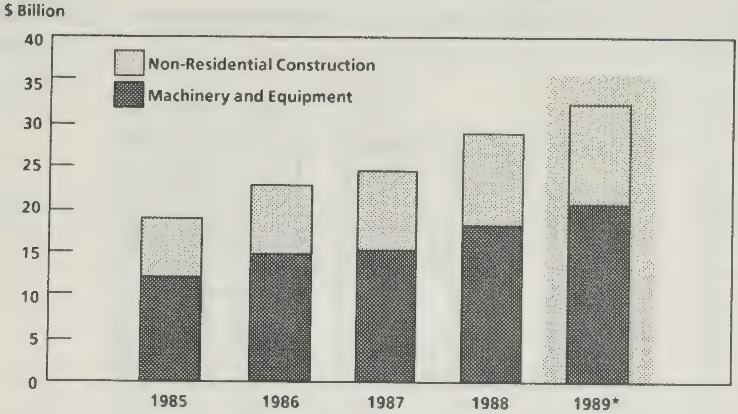
The rise of the Canadian dollar since late 1986 has sharply reduced the cost advantage enjoyed by Ontario industry vis-à-vis U.S. producers. Nevertheless, Ontario remains competitive with other provinces and U.S. states as a production location for most industries. (The issue of competitiveness is discussed more fully in Chapter III.)

Total business investment is forecast to increase from $29.0 billion in 1988 to $32.7 billion in 1989.

- Non-residential construction is expected to grow 10.6 per cent in 1989, after a 15.9 per cent increase this year.

- Machinery and equipment investment is forecast to increase 13.7 per cent in 1989, after an estimated 18.0 per cent increase in 1988.

BUSINESS INVESTMENT
1985-1989



* Forecast

Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

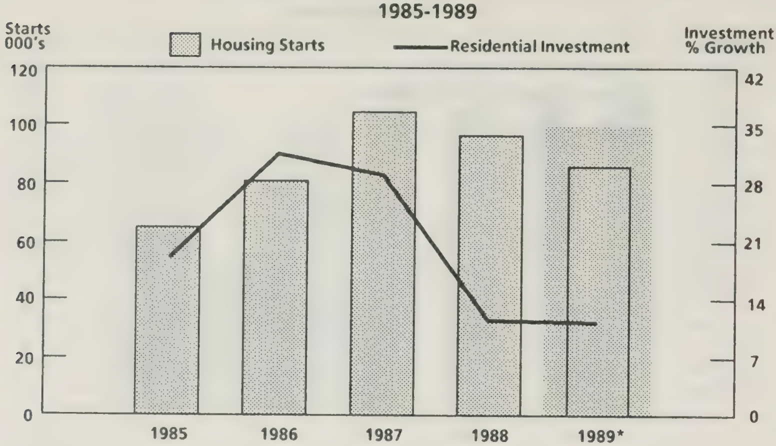
Housing

During the early part of the recovery period, household formation outpaced new home construction, causing vacancy rates to fall well below normal levels of about 3 per cent. Since 1985, strong income and employment growth, lower interest rates, pent-up demand from the recession and high levels of immigration have combined to produce strong demand for housing.

Ontario has experienced three years of strong residential investment spending, primarily due to robust activity in new home construction. Over the 1985-87 period, the annual rate of growth for residential investment averaged 26.4 per cent. During the same period, there were more than 250,000 housing starts, an annualized increase which is well above that of the past decade. In 1987 alone, there were 105,213 starts, the highest level since 1973.

New home construction has continued at a healthy pace during 1988, rebounding quickly from a series of strikes during the summer. Housing starts are estimated to total 98,000 in 1988, the second highest level since 1973.

ONTARIO HOUSING STARTS AND RESIDENTIAL INVESTMENT
1985-1989



* Forecast

Source: CMHC, Statistics Canada and Ontario Ministry of Treasury and Economics.

In 1989, a more sustainable pace of 86,000 starts is expected.

- While the pace of housing starts rose steadily between 1984 and 1987, only since 1987 has new home construction been greater than household formation. With vacancy rates still well below normal levels, new home construction is expected to continue to outpace household formation in 1989.

- Nevertheless, housing activity will be restrained by rising house prices and interest rates.

As housing activity moderates from the extraordinary pace of 1987, the rise in residential investment is expected to slow to 10.1 per cent this year and 9.5 per cent in 1989. Renovation, which currently accounts for about a third of total residential investment, is expected to grow strongly as homeowners continue to improve their property.

Consumer Spending

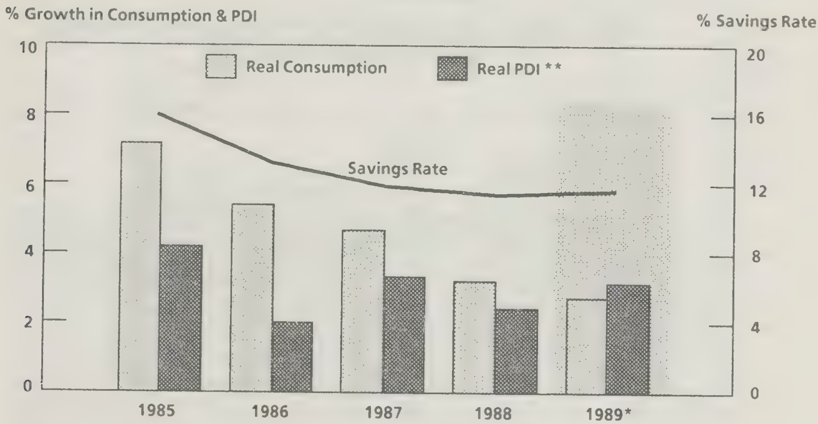
Robust growth in personal income and a decline in the savings rate to a 15-year low fuelled strong consumer spending in 1987. Consumption played a less prominent role in economic growth in 1988. A levelling off in the personal savings rate and slower employment growth will lead to a further reduction in the growth in personal expenditures in 1989.

- Growth in real consumption is forecast at 2.7 per cent in 1989, down from 3.3 per cent in 1988 and 4.7 per cent in 1987.

Spending on services will grow faster than spending on goods. In particular, demand for consumer durables is expected to grow more slowly in 1989. Much of the recent strength in durables reflected the furnishing of newly constructed homes; as the housing boom continues to moderate, this source of demand growth will shrink.

Over the last several years, consumer spending increases have outpaced income growth, driving down the personal savings rate. The savings rate is expected to level off in 1989 as consumers adopt a more cautious spending stance and as savings rates reach those which are contractually fixed (for example, in employer-sponsored pension plans). The rise in interest rates since mid-1988 will also encourage higher personal savings in 1989.

GROWTH IN REAL CONSUMPTION AND SAVINGS RATE 1985-1989



* Forecast

** Personal Disposable Income

Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

Increases in average real wages will partially offset the negative effect of slower employment growth on total personal income. Overall, personal income growth is expected to slow marginally from 8.0 per cent in 1988 to 7.3 per cent in 1989. Recent tax changes have supported growth in disposable income this year, and will continue to do so in 1989.

The burden of household debt payments has grown rapidly since 1985 and will constrain consumer spending in 1989. Between the first quarter of 1985 and the second quarter of 1988, consumer debt by Canadians increased 54.6 per cent while disposable income rose only 19.9 per cent. Interest payments on mortgage debt reached an estimated 25 per cent of household disposable income, up from 18 per cent in 1985. The growth in household debt has also made consumer behaviour more sensitive to interest rate movements and will contribute to slowing consumer spending growth.

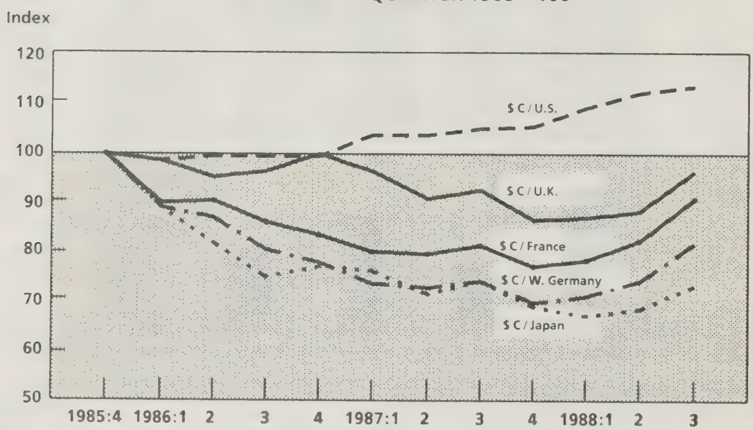
External Trade

Exports have increased sharply in 1988. Ontario's auto producers have gained a larger share of the North American auto market, and strong international demand for industrial inputs has spurred exports of resource products, particularly newsprint, chemicals and metals. In nominal terms, Ontario exports are estimated to have grown by more than 9 per cent in 1988, up sharply from 1.1 per cent the previous year.

Over the first nine months of 1988, total Canadian merchandise exports to the U.S. increased 6.8 per cent. Merchandise exports to other countries rose by 22.6 per cent over the same period. This rapid growth in exports to countries other than the U.S. largely reflects the impact of currency realignments over the past three years.

- Between September 1985 and October 1988, the Canadian dollar depreciated 38.1 per cent against the yen, 27.2 per cent against the mark, 18.5 per cent against the franc, and 10.8 per cent against the pound.

CANADIAN DOLLAR EXCHANGE RATES OF MAJOR CURRENCIES
FOURTH QUARTER 1985 = 100



Source: Bank of Canada.

Overall, Ontario's nominal trade balance is estimated to have improved in 1988, thanks to the rebound in auto exports and much improved terms of trade. In real terms, however, imports of goods and services are growing considerably faster than exports. External trade is therefore having a negative impact on the rate of real growth.

A small decline in the nominal trade surplus is expected in 1989. In real terms, trade will continue to restrain growth.

Exports to the United States are expected to rise next year, although the increase will be limited by weaker growth in the U.S. economy. The ongoing effect of recent currency changes, coupled with the relatively strong growth expected in Japan, should lead to a continuing rise in the share of exports destined for third countries in 1989. Within Canada, weakness in Ontario's exports to Western Canada should be offset by stronger exports to Quebec and the Atlantic provinces. Strong investment spending growth in Ontario will lead to a further increase in imports of machinery and equipment.

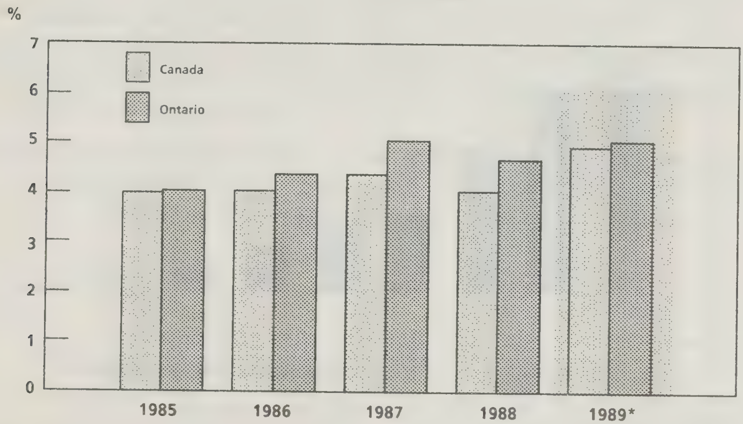
- Exports will increase by $3.6 billion to $120 billion in 1989.

- Imports are forecast to reach $108 billion in 1989, up $5 billion or 4.9 per cent, from the level in 1988.

Inflation

Inflation has been remarkably stable over the past four years, despite increasing tightness in labour markets. Over the 1985 to 1988 period, Ontario's inflation rate, as measured by the Consumer Price Index, ranged from a low of 4.1 per cent to a high of 5.1 per cent.

CANADA AND ONTARIO CPI INFLATION
1985-1989



* Forecast
Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

For 1988, Ontario's inflation rate is estimated at 4.7 per cent, down from 5.1 per cent in 1987. Nationally, consumer prices increased approximately 4.1 per cent in 1988, compared to 4.4 per cent in 1987. The 1988 easing of inflation reflects smaller increases in food prices and lower costs for petroleum products.

In 1989, inflation is expected to rise to 5.1 per cent in Ontario and to 4.9 per cent nationally. Several factors will contribute to the rise in inflation.

- The 1988 drought is expected to add to price pressures next year.
- The recent run-up in many non-agricultural raw material prices will be passed through into consumer prices.
- Wage increases exceeded the inflation rate in 1988. The resulting real wage gains may increase upward price pressures, particularly for services.

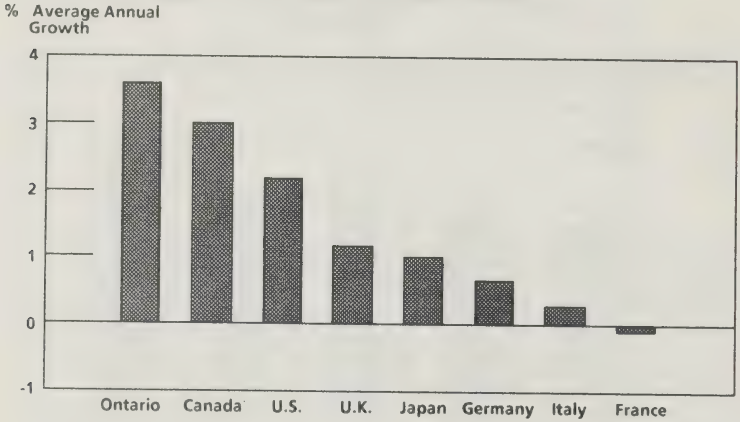
Partially offsetting these factors will be the ongoing impact of Canadian dollar appreciation, less rapid economic growth and an expected slowing in house price increases. Oil prices may also contribute to moderating inflationary pressure in 1989, although to a smaller degree than in 1988.

The gap between the Ontario and national inflation rates in recent years has been primarily the result of greater house price increases in the Toronto region. In 1989, the Ontario-Canada gap is expected to narrow as house price increases in southern Ontario moderate.

Employment and the Labour Force

Over the four-year period 1985 to 1988, the number of employed Ontarians increased by 643,000 -- an average annual growth rate of 3.6 per cent, higher than in any major industrial country.

INTERNATIONAL COMPARISON OF EMPLOYMENT GROWTH
1985-1988



Source: O.E.C.D., Statistics Canada and Ontario Ministry of Treasury and Economics.

In 1989, employment is forecast to grow by 105,000. The unemployment rate will average 5.0 per cent next year, unchanged from 1988.

Ontario Labour Market Outlook — **Table 2**

	1987	1988	1989
Labour Force (000s)	5,013	5,145	5,253
Change (%)	2.4	2.6	2.1
Employment (000s)	4,706	4,886	4,991
Change (%)	3.3	3.8	2.1
Job Creation (000s)	151	180	105
Unemployment (000s)	307	259	262
Unemployment Rate (%)	6.1	5.0	5.0
Participation Rate (%)	68.9	69.4	69.7

Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

Job Growth

Jobs Across Industries

In recent years, the industrial composition of employment in Ontario has largely continued along long-term trends. In 1988, the service sector accounted for 68.2 per cent of the employed workforce, compared to 66.6 per cent in 1985.

- During the 1985 to 1988 period, the community, business and personal services industry contributed the largest number of new jobs, but the highest percentage growth in employment occurred in the communications industry.
- Within the goods-producing sector, employment growth was fastest in construction, reflecting the boom in the commercial and residential property markets. Manufacturing employment grew by over four per cent.
- Employment in the primary sector grew by almost two per cent. While the mining industry posted a healthy 29 per cent increase, reflecting strong commodity prices, employment in agriculture and forestry fell.

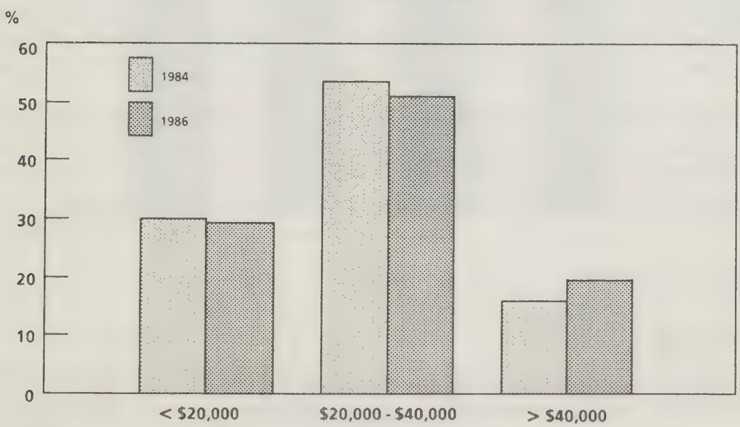
The private sector's share of Ontario employment remained unchanged at about 80 per cent over the 1985 to 1988 period. Self-employment accounted for 16 per cent of private sector employment.

Employment growth in the public sector, broadly defined to include all public enterprises and institutions which rely primarily on public funds, was concentrated in education, health and social services.

The Quality of Employment

The number of full-time, full-year workers earning over $40,000 (1986 dollars) increased 35 per cent between 1984 and 1986, while the number earning less than $40,000 increased slightly over six per cent. As a result, the proportion of full-time, full-year employment accounted for by higher-paid earners increased from 16 per cent in 1984 to 20 per cent in 1986. The share of lower-paid earners fell by four percentage points.

ONTARIO EMPLOYMENT BY EARNINGS* CATEGORY
1984 - 1986



* In 1986 Dollars. Includes full-time, full-year paid employment by heads of households, spouses and unattached individuals.

Source: Statistics Canada.

Employment in the managerial and professional occupations showed strong growth in 1988 and is expected to continue the trend underway since the expansion began.

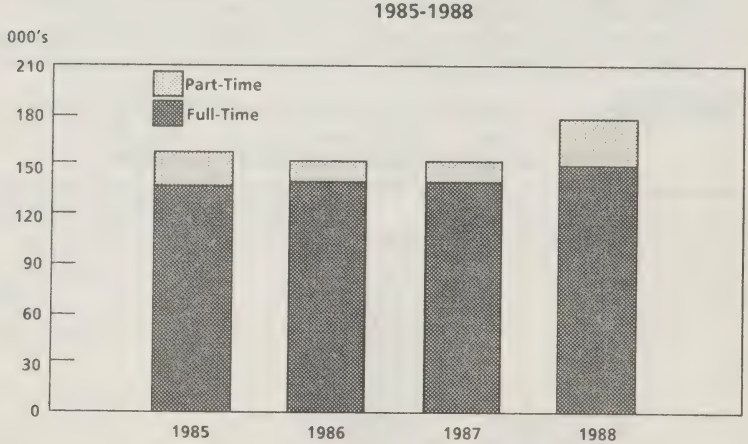
- The number of workers in these occupations increased 25 per cent over the 1985 to 1988 period, compared to 12 per cent for other occupations. These occupations continue to be the highest paid in the labour market.
- Managerial and professional occupations accounted for 30 per cent of all Ontario employment in 1988.

Full-Time Jobs

Over the four-year period ending in 1988, full-time employment expanded by 16 per cent, compared to 12 per cent for part-time work.

- Full-time job creation has accounted for 88 per cent of the total new employment in this period.
- The largest addition to part-time employment occurred in the trade and the community, business and personal services sectors which together contributed 70,000 part-time jobs.

ONTARIO JOB CREATION
1985-1988



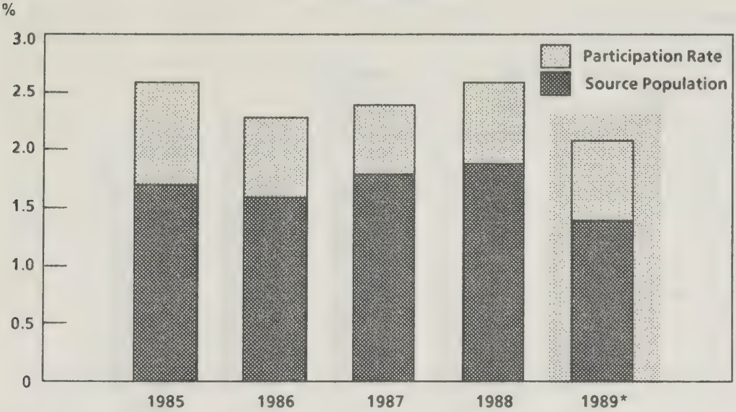
Source: Statistics Canada.

The Labour Force

Ontario's labour force increased by an estimated 479,000 over the 1985 to 1988 period. The number of adult women in the labour force rose by 295,000 and adult men by 203,000. The number of young workers declined slightly as the smaller cohorts of the post-baby boom generation entered the labour market.

Ontario's labour force is expected to grow by 2.1 per cent in 1989, down from 2.6 per cent in 1988. Source population growth contributed 73 per cent of the 1988 growth in labour supply, with participation rate increases accounting for the remaining 27 per cent.

ONTARIO LABOUR FORCE GROWTH
1985-1989



* Forecast

Source: Statistics Canada and Ontario Ministry of Treasury and Economics

Population Growth

About 50 per cent of international migrants and 55 per cent of interprovincial migrants enter the labour force on arrival in Ontario.

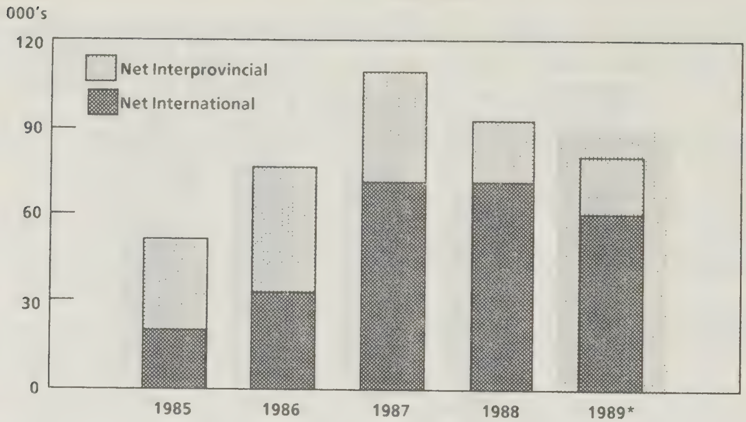
Ontario's population grew from 9.0 million in 1985 to 9.4 million in 1988. Net migration accounted for almost 60 per cent of this growth.

Net migration to Ontario from outside Canada was high over the 1986-1988 period, averaging about 59,000 per year. In 1987, net international migration, including refugee claimants, reached 72,000, the highest level since 1975. The 1988 level is expected to be similar to that in 1987.

Net interprovincial migration has played an important, though smaller, role in Ontario's recent population growth. Net interprovincial migration averaged 35,000 per year over the 1986-1988 period, reflecting the faster economic recovery in Ontario. The net inflow is now slowing and should amount to 22,000 in 1988, down from 38,000 in 1987.

In 1989, net external migration to Ontario is likely to decline to 80,000 from 94,000 in 1988. Net international migration will moderate as a result of a decrease in refugee claimants, following passage of federal legislation in 1988. As well, Ontario's share of total Canadian immigration should decline from the unusually high levels recorded this year. Net interprovincial migration will continue to decline, but not as rapidly as in 1988.

MIGRATION TO ONTARIO
1985-1989



* Forecast.

Source: Statistics Canada, Employment and Immigration Canada and Ontario Ministry of Treasury and Economics.

Participation Rates

Strong demand for labour has encouraged persons outside the labour force, primarily women and young people, to enter the job market. The increase in labour force participation over the 1985 to 1988 period has added about 150,000 workers to Ontario's labour supply.

In 1988, Ontario's aggregate labour market participation rate increased to 69.4 per cent, the highest in Ontario's history. By way of comparison, the U.S. aggregate labour force participation rate is 66 per cent. Ontario's rate is higher than that of any of the ten largest industrial states in the United States.

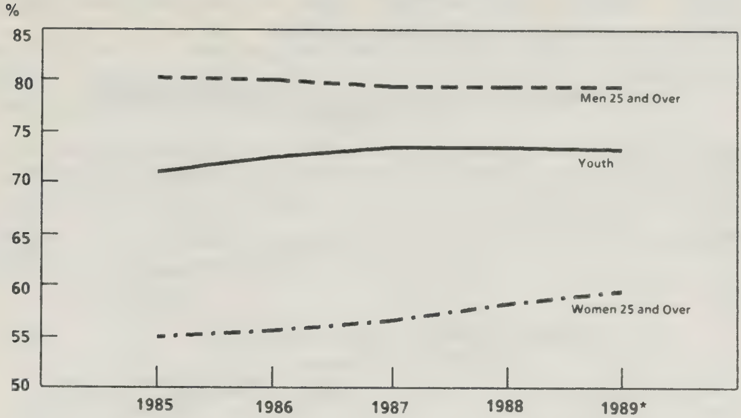
The participation rate of adult men was more than 79 per cent in 1988, about the same as the 1987 level. Over the long-term, the male participation rate has been declining.

The participation rate of women aged 25 and over has increased by more than four percentage points over the past four years, reaching 58 per cent in 1988. The gap between adult male and adult female rates will narrow to about 20 percentage points in 1989. The female share of the labour force is expected to rise to slightly over 45 per cent in 1989.

The youth participation rate was over 73 per cent in 1988, an increase of almost three percentage points since 1985. This reflects higher part-time labour force participation among young people; full-time labour force participation by youth declined over the period. This is consistent with increasing educational enrollment; the full-time school enrollment rate for young people rose by about five percentage points over the 1985 to 1988 period.

Prime-age workers (25-44) will constitute 53 per cent of the labour force in 1989, up from 50 per cent in 1985.

ONTARIO PARTICIPATION RATES
1985-1989



* Forecast

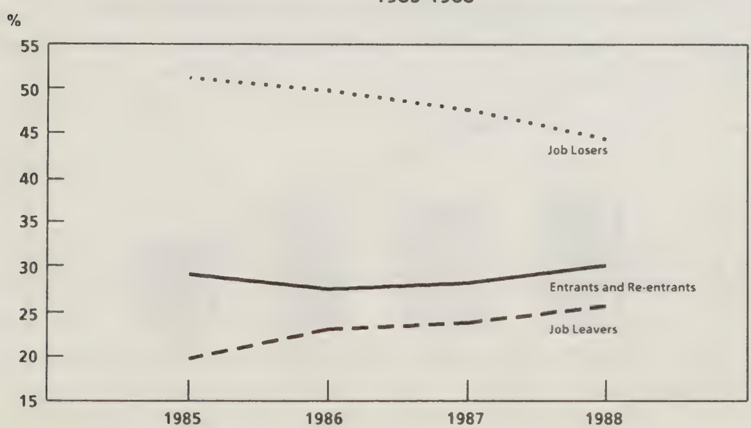
Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

Changing Patterns of Unemployment

The continuing economic expansion has not only reduced unemployment in Ontario; it has also changed its nature.

Layoffs have become less important as a cause of unemployment. The job losers' share of total unemployment fell from 51 per cent to 44 per cent during the 1985-1988 period, while the share of entrants and re-entrants edged upward. The proportion of unemployment accounted for by job leavers rose from 20 per cent in 1985 to 26 per cent in 1988.

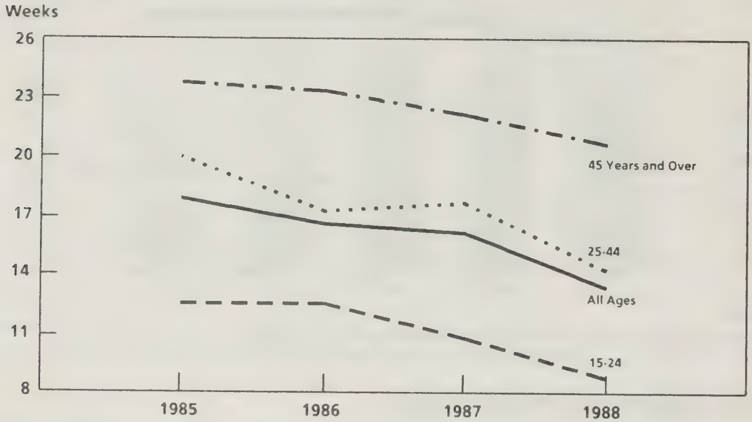
COMPONENTS OF ONTARIO UNEMPLOYMENT
1985-1988



Source: Statistics Canada.

The average duration of unemployment returned to pre-recession levels for the first time in 1988. On average, unemployed persons were without work for 13 weeks in 1988. Only for older workers (aged 45 and over) was the average duration of joblessness longer in 1988 than in 1981.

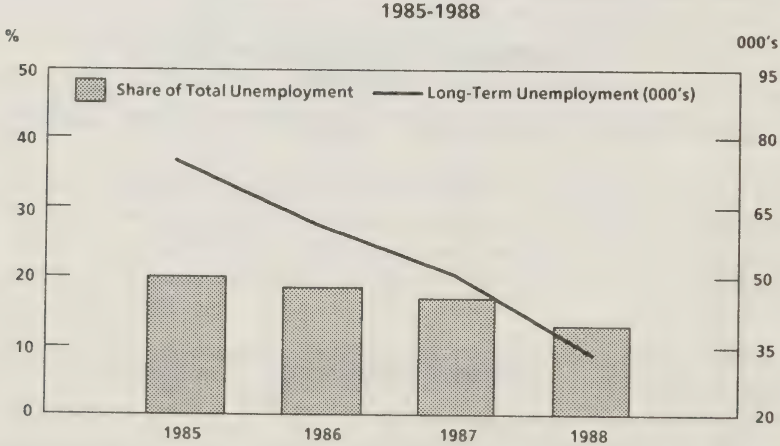
ONTARIO AVERAGE DURATION OF UNEMPLOYMENT
1985-1988



Source: Statistics Canada.

Long-term unemployment, defined as unemployment of six months or more, has also declined substantially. In 1988, long-duration unemployment declined in all parts of Ontario, with the largest decline in Northern Ontario.

ONTARIO LONG-TERM UNEMPLOYMENT
1985-1988



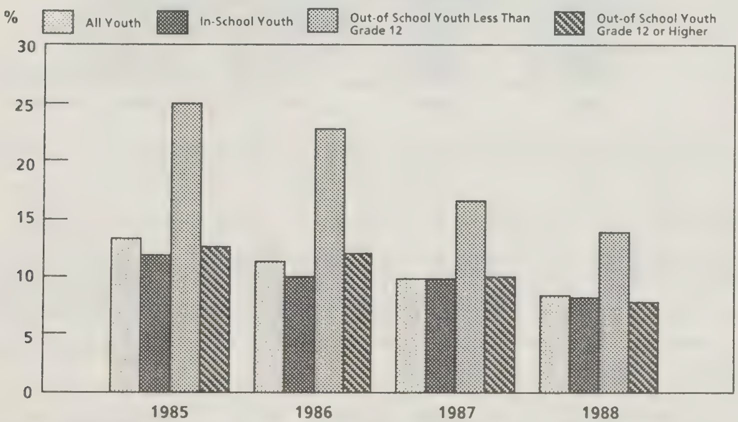
Source: Statistics Canada.

The number of workers unemployed for more than six months averaged 33,000 in 1988, down from 51,000 in 1987. This compares to a pre-recession level of 41,000 in 1981.

The least educated are over-represented in long-term unemployment. In 1988, those with no post-secondary education accounted for 58 per cent of the labour force, but 67 per cent of long-term unemployment.

The youth unemployment rate fell from 13.2 per cent in 1985 to 8.5 per cent in 1988. The decline was most significant for school dropouts, whose unemployment rate fell from 25 per cent in 1985 to about 16 per cent in 1988. The number of unemployed dropouts, defined as out-of-school youth with less than grade 12 education, fell from 46,000 to 22,000 over the period.

ONTARIO YOUTH UNEMPLOYMENT RATES
1985-1988



Source: Statistics Canada.

Strong job growth in 1988 has reduced unemployment rates in all major urban areas of the province. Labour markets were particularly tight in Toronto, London, Oshawa and Kitchener-Waterloo, all of which had unemployment rates of less than five per cent in 1988.

Compensation

Earnings

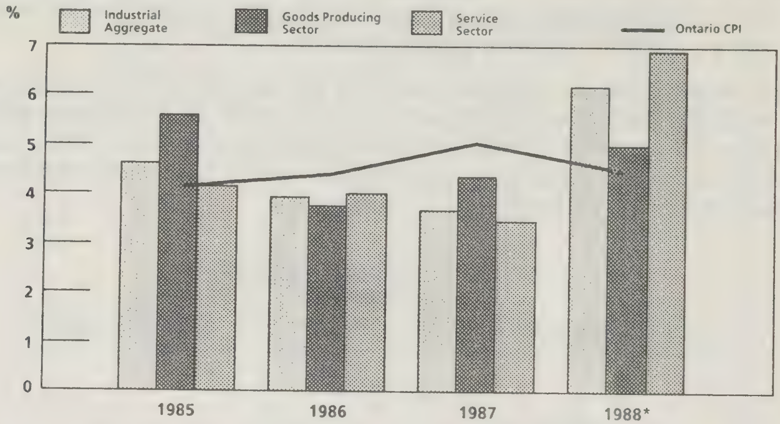
Ontario weekly earnings per worker have shown modest real growth since late 1987, reflecting strong economic performance and increasingly tight labour markets.

- Average weekly earnings increased by 6.2 per cent in the first eight months of 1988, compared to the same period in 1987. This represented real growth of 1.7 percentage points above the Ontario consumer price rise of 4.5 per cent.

Weekly earnings increases were most pronounced in the service sector, particularly the finance, insurance and real estate, and the community, business and personal services industries. The higher service sector earnings growth in

1988 represents a reversal of the previous year's experience when earnings growth in this sector lagged behind growth in the goods-producing sector.

ONTARIO WEEKLY EARNINGS INCREASES
1985-1988



* **January to August 1988.**
Source: Statistics Canada.

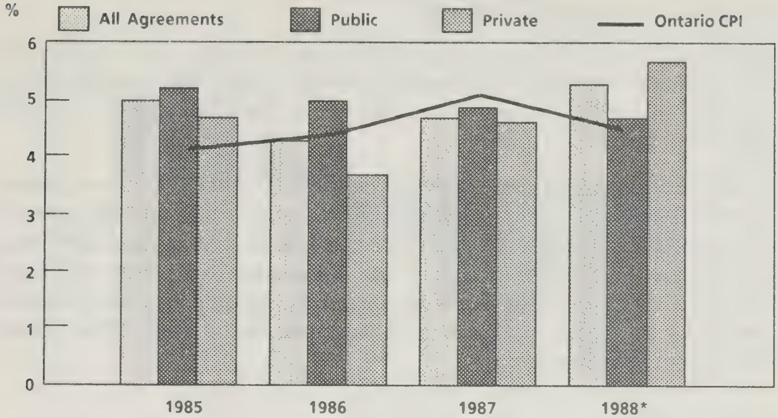
Wage Settlements

Collective bargaining settlements in Ontario through the first three quarters of 1988 averaged 5.3 per cent, up from 4.7 per cent in 1987. Inflation in the same period averaged 4.5 per cent. Higher average wage settlements reflect continuing economic growth, stronger employee emphasis on wage gains, and high settlements in the construction industry.

- Private sector settlements exceeded those in the public sector in the first three quarters of 1988, averaging 5.7 per cent, compared to 4.7 per cent for the public sector.

- Construction settlements averaged 6.2 per cent and accounted for about 40 per cent of all employees covered by collective agreements negotiated in the first three quarters of 1988.

ONTARIO WAGE SETTLEMENTS, 1985-1988
(OVER 500 EMPLOYEES)



* January to September 1988 .
Source: Labour Canada and Statistics Canada.

Ontario wage increases continue to exceed those at the national level.

- In the first three quarters of 1988, Canadian settlements for the private and public sectors averaged 4.2 per cent, up slightly from 4.1 per cent in 1987.

In 1989, Ontario settlements will continue to lead those in the rest of the country. Wage increases are also likely to remain somewhat above inflation.

Non-wage Compensation

Major non-wage compensation items include mandatory employer payments for the Canada Pension Plan (CPP), Unemployment Insurance (UI), and Workers' Compensation (WCB), as well as non-mandatory payments for Ontario Health Insurance (OHIP), and private health and pension plans. Over the 1985 to 1988 period, non-wage compensation has constituted a stable 9.2 per cent of labour income.

Over the same period, mandatory employer payments for UI, CPP, and WCB have grown faster than non-mandatory items; in 1987, they accounted for about half of total non-wage payments. The main increases occurred in WCB and UI premiums. The pace of WCB premium growth is expected to slow due to the recent legislative reforms in workers' compensation and occupational health and safety. UI contribution rates will decrease in 1989 as a result of a projected UI fund surplus. CPP premiums will continue to increase in 1989 and future years as a result of the federal government's amendments to the CPP Act.

Ontario Manufacturing Investment

Manufacturing Investment Outlook

Following three years of extremely rapid growth (15.1 per cent per year), manufacturing investment is expected to grow by about 4 per cent per year over the period 1989 to 1992. Investment outlays by Ontario manufacturers should exceed $10 billion in 1992.

The slowing in investment growth over the forecast period reflects the expected easing in overall economic growth, a higher exchange rate, and the completion of major restructuring and new capacity additions in the automotive and steel industries. Expenditures on machinery and equipment, however, will continue to be driven by the need to modernize and remain competitive in world markets. A greater emphasis on modernization and replacement rather than on capacity additions is expected to continue.

Recent Performance

Over the past three years, investment in manufacturing has been an important source of growth for Ontario's economy. Firms have undertaken major expenditures, particularly in automobiles and steel, to introduce new technologies and enhance international competitiveness.

Ontario manufacturing investment growth was very strong in the 1986 to 1988 period, with double-digit growth in most manufacturing industries.

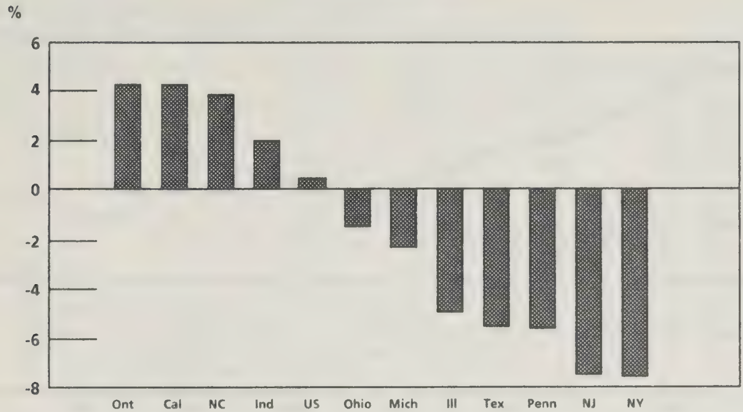
- Manufacturing outlays on plant and equipment in 1988 are expected to be up by 17.4 per cent relative to 1987 levels.

Particularly rapid growth is occurring in the wood, paper and allied and non-metallic minerals industries. Only three industries are anticipating a reduction in 1988 capital expenditures: primary metals, metal fabricating and printing and publishing.

The strength in investment is reflected in job growth. Ontario job creation in manufacturing has outpaced that in the United States.

- Over the 1985 to 1988 period, Ontario manufacturing employment grew by 4. 4 per cent, or 44,000 jobs. Manufacturing employment fell by 2.1 per cent over the same period in the ten largest industrial states in the U.S., reflecting a net loss of 227,000 jobs.

MANUFACTURING EMPLOYMENT GROWTH
1985-1988

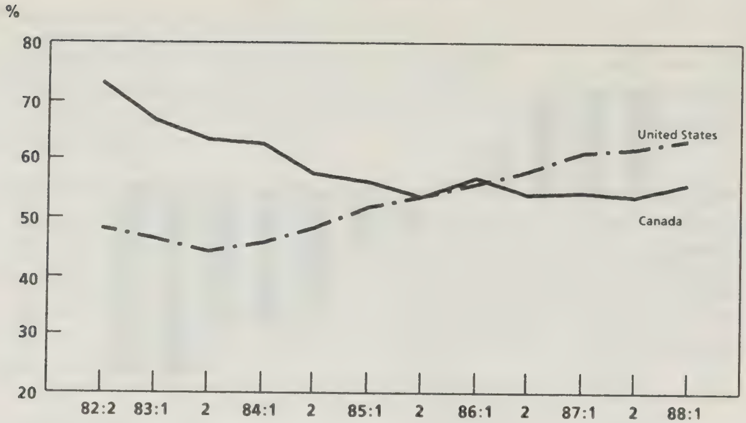


Note: **1988 Forecast.**
Source: Statistics Canada , D.R.I. and U.S. Department of Commerce.

The overall strength of manufacturing investment growth has been driven by rapid sales increases, high capacity utilization rates, strong profit growth and a much improved debt/equity ratio.

- Sales Growth: Manufacturing shipment increases averaged 7.5 per cent in the 1984-87 period, with the highest growth for non-metallic minerals, wood, machinery, and transportation equipment.
- Capacity Utilization: Capacity utilization stood at 86.3 per cent in the first half of 1988, some 15 percentage points above the 1981-82 recession level. Manufacturing industries that are operating at rates of 95 per cent or higher are rubber and plastic products and non-metallic mineral products. The higher rates of capacity utilization were achieved despite noticeable additions to capacity. In the past three years, total manufacturing capacity has risen by 11 per cent. Increases in excess of 35 per cent have occurred in the transportation equipment and electrical and electronics sectors.
- Profitability: Operating profits as a share of sales in the manufacturing sector have increased from two per cent in 1982 to six per cent in 1987. Profitability has returned to levels experienced prior to the recession. Within manufacturing, the strongest profit performance was achieved in paper and forestry, printing and publishing, primary metals, textile and knitting mills and wood industries.
- Debt/Equity Ratios: Although still above pre-recession levels, the average ratio of debt to equity in Canadian manufacturing fell from 73 per cent in late 1982 to 56 per cent in the first half of 1988. By contrast, the U.S. debt/equity ratio, which was well below the Canadian level early in the decade, has risen sharply and now exceeds the Canadian level.

MANUFACTURING DEBT/EQUITY RATIOS
1982-1988



Source: Statistics Canada and U.S. Department of Commerce.

Manufacturing Competitiveness

While the factors reviewed above are providing the overall impetus for manufacturing investment growth, manufacturing investment location decisions are based on an additional set of considerations. Factors contributing to Ontario's attractiveness as a location for investment include favourable labour and energy costs, productivity (which is largely dependent on new technology and new products), a growing and increasingly well-educated labour force, and an efficient public infrastructure.

Exchange Rates

In recent years, changes in international currency exchange rates have dwarfed other factors, such as increases in labour compensation or productivity growth rates, as a cause of variations in international competitiveness.

- Since 1985, Japanese and European exchange-adjusted hourly compensation costs have risen dramatically in relation to U.S. and Canadian rates. Japanese rates are becoming comparable; European rates are significantly higher.
- Since 1987, Canadian compensation costs have risen virtually to U.S. levels, primarily as a result of exchange rate changes, while as recently as 1985 they were 17 per cent below U.S. levels.

Hourly Compensation for Production Workers in Total Manufacturing: 1975-1988
Canada, U.S., South Korea, Japan, West Germany
(Index U.S. = 100)

Table 3

Country	1975	1980	1985	1987	1988*
United States	100	100	100	100	100
Canada	91	85	83	89	96
South Korea	6	10	10	13	14
Japan	48	57	50	83	93
West Germany	100	125	74	126	129

Source: U. S. Department of Labor

Notes: * Applying January - October 1988 average exchange rates to 1987's compensation costs.
For other years, data adjusted for each year's exchange rates.
Compensation includes wages and benefits.

As the following table indicates, at current exchange rates, Canadian hourly compensation costs in manufacturing remain slightly below U.S. manufacturers in many industries, but are higher in other industries such as paper, wood products and textiles.

Hourly Compensation for Selected Industries, 1988
Canada, U.S., Japan, Korea, Germany
(In U.S. Dollars, applying January-October 1988 exchange rate to 1987 compensation costs)

Table 4

Industry	Canada	U.S.	Japan	Korea	Germany
Total Manufacturing	**12.85**	**13.44**	**12.48**	**1.99**	**17.30**
Transportation Equipment	15.16	18.54	15.68	2.85	21.70
Electrical Products	12.18	13.59	11.32	1.96	16.67
Textiles	9.80	9.11	9.14	1.65	13.29
Lumber and Wood Products	11.61	10.49	10.07	1.81	15.54
Fabricated Metals	12.63	13.56	12.27	2.09	15.92
Machinery	13.39	14.55	14.22	2.28	18.05
Chemicals	13.79	17.03	20.08	2.79	19.61
Paper	16.86	15.76	13.37	2.15	15.99
Food and Related (Processing)	11.93	12.45	10.34	2.08	14.70

Source: U. S. Department of Labor.

Ontario hourly earnings (excluding benefits) for the manufacturing sector as a whole also remain in line with most major U.S. industrial states. Production workers in Ontario manufacturing earned an average of $10.75 U.S. per hour (not including benefits) during the first two quarters of 1988. These hourly earnings are comparable to the major industrial states bordering the province, such as New York and Ohio. They are substantially below those in Michigan. However, if the exchange rate were to increase to $0.85 U.S., Ontario's hourly earning levels would be higher than in seven of the ten largest manufacturing states.

Hourly Manufacturing Earnings, 1988 (U.S. Dollars)			Table 5
North Carolina	8.06		
Ontario ($Cdn = 75 cents U.S.)		**9.83**	**(2nd rank)**
Texas	9.93		
Pennsylvania	10.18		
New York	10.30		
Ontario ($Cdn = 82 cents U.S.)		**10.75**	**(5th rank)**
California	10.80		
New Jersey	10.81		
Illinois	11.07		
Ontario ($ Cdn = 85 cents U.S.)		**11.14**	**(8th rank)**
Indiana	11.36		
Ohio	11.95		
Michigan	13.36		

Note: Based on January-June 1988.
Source: Statistics Canada and U.S. Department of Labor.

International Competitiveness: Electricity Rates

Ontario has a substantial advantage over most U.S. states in industrial power costs due to Ontario's low-cost hydro-electric and nuclear power generation.

- The average monthly industrial electricity bill in most major industrial states is more than 50 per cent higher than in Ontario.

Monthly Industrial Electricity Bill, 1988 (Canadian Dollars)		Table 6
New York	New York	45,039
Massachusetts	Boston	38,857
California	Los Angeles	34,555
Michigan	Detroit	34,028
Illinois	Chicago	34,005
North Carolina	Charlotte	29,458
Texas	Dallas	23,328
Ontario	**Toronto**	**22,104**

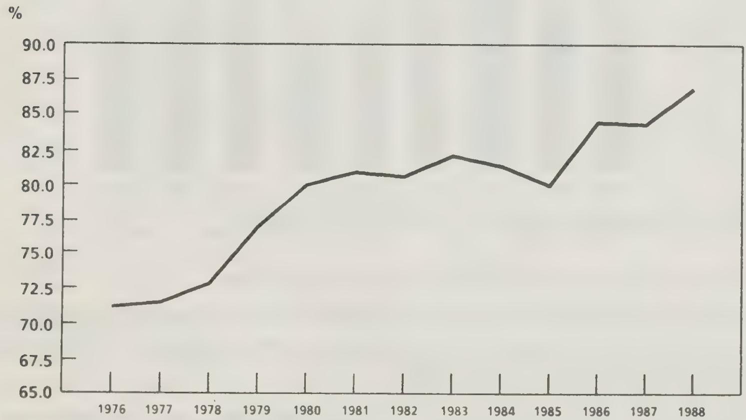
Note: Relevant exchange rate is $1 Cdn = $0.82 U.S.
Based on industrial user with 400,000 kW.h consumption and peak demand of 1,000 kW (July 1988 rates).
Source: Ontario Hydro and the Tennessee Valley Authority.

New Machinery: Added Productivity

During the 1985 to 1988 period, manufacturing productivity has grown an estimated 11.8 per cent, faster than that of the service sector. Productivity increases have been particularly high in industries such as pulp and paper. High productivity gains are also anticipated in motor vehicle assembly as recent investments lead to major increases in output.

The underlying reason for this increase in productivity has been investment in new machines embodying more productive technologies that improve product quality, reduce labour costs and increase control over the production process. This is reflected in changes in the composition of investment by Ontario manufacturers.

MACHINERY AND EQUIPMENT EXPENDITURES AS A % OF TOTAL CAPITAL EXPENDITURE, ONTARIO MANUFACTURING INDUSTRIES 1976-1988



Source: Statistics Canada.

- In 1976, 71 per cent of capital outlays were for machinery and equipment and the remaining 29 per cent were for buildings.
- By 1988, 87 per cent of capital outlays were for acquisition of machinery and equipment.
- By 1985, an estimated 43 per cent of manufacturing firms in Canada had installed some form of process automation. The most commonly used form of process automation was computer-based manufacturing, followed by computer-aided design and computer numerical control.

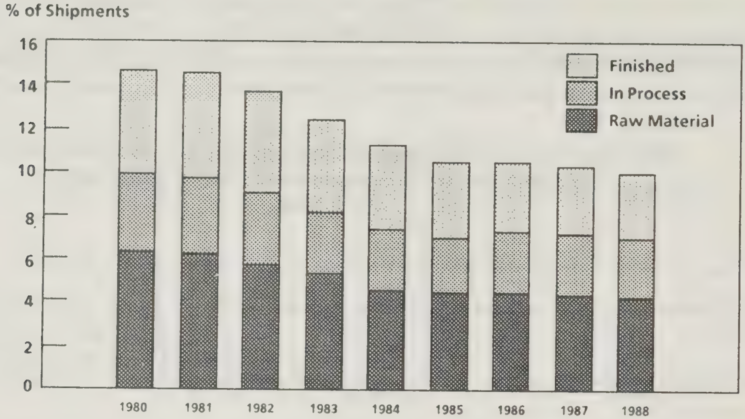
Based on the results of a 1985 survey, manufacturing expenditures on robotics and computer equipment represented 13 per cent of total machinery and equipment investments. Even larger investment levels in robotics and computerized equipment have been realized since 1985, particularly in the automotive sector.

Advances in information technology, much improved process equipment and new relationships with suppliers, such as just-in-time delivery, have led to substantial

reductions in costs. These reductions are, in part, achieved by declining inventory-to-shipment ratios for raw materials, goods-in-process and for finished goods.

- Measured as a percentage of sales, manufacturing inventories fell from 14.8 per cent in 1980 to 10.2 per cent in 1988.

INVENTORY / SHIPMENT RATIO: ONTARIO MANUFACTURING SECTOR 1980-1988



Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

New Products: Research and Development Expenditure

New high-value added products are also essential to productivity growth. In this regard, research and development expenditures are a measure of the potential for inventions of new products and processes.

While expenditures on R&D by Ontario manufacturers as a proportion of output are still less than half the levels of their counterparts in the U.S., R&D expenditures by Ontario manufacturing have more than tripled between 1979 and 1986.

- In 1986, Ontario's manufacturing accounted for 64.6 per cent of Canadian manufacturing R&D expenditures, compared with 56.1 per cent in 1979.

- Ontario accounts for more than 85 per cent of Canadian R&D in telecommunications, 70 per cent in primary metals, 67 per cent in food processing, and 86 per cent in scientific equipment.

The federal and provincial governments support R&D performed by business through tax expenditures and other forms of assistance.

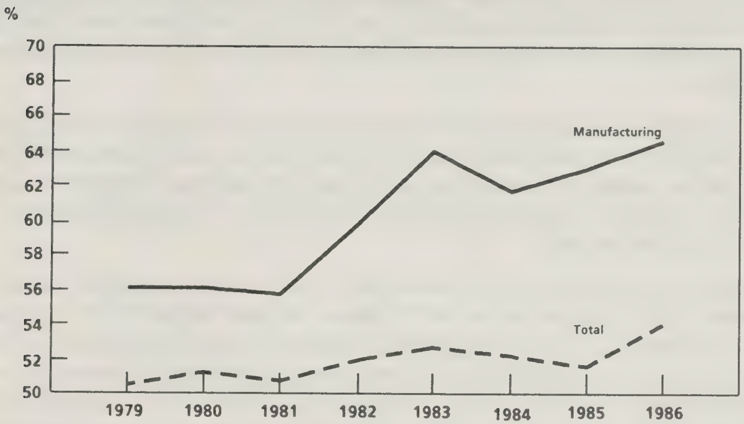
- A corporation increasing its R&D expenditures in Ontario by one dollar would incur an after-tax cost of 40.6 cents, after federal and provincial tax expenditures are taken into account. This level of tax support is generous relative to that provided by other countries.

- The 1988 Ontario Budget increased the level of tax support for R&D with the introduction of the Research and Development Super Allowance, at an estimated cost in revenue foregone of $45 million in the first full year.

- In addition to tax support, direct funding of business R&D by government grants and contracts accounted for 8.7 per cent of R&D performed by Ontario businesses in 1986.

Continued improvement in R&D-related activities in Ontario will lead to higher investment, higher productivity, improved competitiveness and higher output.

ONTARIO RESEARCH AND DEVELOPMENT EXPENDITURES AS A SHARE OF CANADA 1979 - 1986

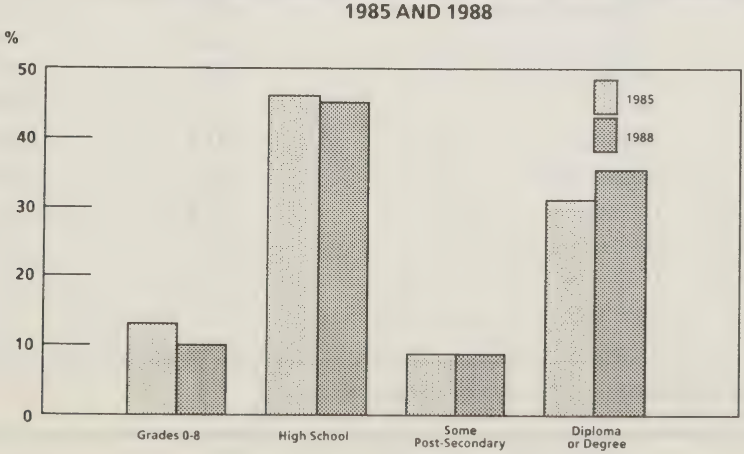


Source: Statistics Canada.

Skilled Labour Force

Education levels are high and continually improving as increasing numbers of Ontario students pursue post-secondary education programs. The share of the adult labour force with a completed college or university education rose from 31.3 per cent in 1985 to 35 per cent in 1988.

ONTARIO'S ADULT LABOUR FORCE BY EDUCATIONAL ATTAINMENT 1985 AND 1988



Source: Statistics Canada.

There are 12 universities with engineering programs in Ontario. Annually, about 3,100 bachelors degrees, 700 masters degrees and 150 doctorates are awarded in the field of engineering. In addition, Ontario colleges of applied arts and technology graduate about 14,000 business and technology students each year. The province also benefits from the high average level of professional and technical skills of international and interprovincial migrants.

Skills and Supplier Base

Ontario, with over 50 per cent of Canadian manufacturing, has a higher industrial concentration in manufacturing (25.5 per cent of gross provincial product) than the U.S. as a whole (19.7 per cent) and all but four of the largest states in the United States.

Ontario's supplier base for manufacturing is particularly strong, given the province's strength in industries such as auto parts, steel, machinery, electrical and electronics, metal fabrication, plastics and chemicals. Toronto as a centre for high quality business and financial services is also a significant advantage to provincial manufacturers.

Manufacturing employment accounts for over 20 per cent of total Ontario employment. This share ranks with those of the largest U.S. states. To a prospective investor, a large employment base in manufacturing indicates an experienced industrial workforce, as well as a significant potential supply of skilled trades. Interprovincial and international migration into Ontario responds quickly to tight labour markets, giving Ontario's labour market a high degree of flexibility. In addition, Ontario's extensive training investments and its mobile labour force provide a continuing source of highly qualified workers for the manufacturing sector.

Manufacturing Employment: Ontario Compared to Ten Largest U.S. States, 1988 — **Table 7**

Rank	State	Share (%) of Total Employment	Manufacturing Employment (000's)
1	North Carolina	27.0	862.5
2	Indiana	23.9	630.2
3	Michigan	22.2	930.3
4	Ohio	22.2	1,099.1
5	**Ontario**	**21.2**	**1,034.0**
6	Pennsylvania	19.3	1,050.3
7	Illinois	17.6	945.0
8	New Jersey	17.4	667.6
9	California	16.1	2,139.5
10	New York	15.0	1,218.2
11	Texas	12.3	944.2

Source: Statistics Canada and U.S. Department of Commerce.
Note: Based on January-September 1988 average monthly employment.

Public Infrastructure

Industry in Ontario benefits from a comprehensive network of public infrastructure. The provincial highway system, comprising 21,000 kilometres, is extensive and toll-free. In addition, airports, railways and marine transportation systems further enhance the movement of goods and people. Wide-ranging and comprehensive telecommunication systems facilitate the transfer of information and data throughout the province. For the past four fiscal years, including 1988-1989, $10.1 billion has been allocated by the Province for budgetary capital expenditures for areas such as transportation, health, education and the environment.

The Medium Term and Sector Outlook

Sustained Moderate Growth

The Canadian and Ontario economies will continue to expand through the medium term, but at a much slower pace than in recent years, reflecting primarily slower growth of the labour force.

The Ontario Economy: 1990-1992 (Annual Average)	Table 8
Real Growth (%)	2.7
Inflation (%)	4.8
Job Creation (000s)	102
Unemployment Rate (%)	5.0

Source: Ontario Ministry of Treasury and Economics.

Over the 1990-1992 period:

- Real output growth will average 2.7 per cent per year;
- Employment will grow by 2.0 per cent or 102,000 jobs annually;
- Productivity will increase by 0.6 per cent per year;
- The inflation rate will average 4.8 per cent; and
- The unemployment rate will average 5.0 per cent.

Medium Term Sector Outlook

Led by the transportation equipment sector -- with expected output growth of 3.8 per cent annually -- Ontario's industrial sectors will continue the broadly based expansion over the medium term. In line with the economy as a whole, manufacturing output growth will be slower than it has been in the recent past.

Sector Outlook for Ontario — **Table 9**

	1987		Real Output Growth		
	Employment	**Real Output**	**1988**	**1989**	**1990-92**
	(000s)	(1981 $ Million)	%	%	%
Goods Producing Sector	**1,547**	**58,701**	**4.4**	**2.6**	**2.7**
Primary	182	6,201	2.2	5.0	2.2
Manufacturing (total)*	1,038	38,196	4.6	1.9	2.8
Resource-Based	152	5,683	1.5	0.7	1.4
Industrial Products	378	15,362	4.7	2.6	2.4
Transportation Equip.	190	7,445	9.1	0.7	4.9
Consumer Products	275	8,485	2.6	2.5	2.4
Construction	274	10,602	5.2	3.1	2.5
Utilities	53	3,703	3.6	4.1	3.3
Service Sector	**3,159**	**90,493**	**4.6**	**3.1**	**2.6**
Total	**4,706**	**149,194**	**4.5**	**2.9**	**2.7**

Note: *Includes miscellaneous manufacturing.
Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

Manufacturing Sector Outlook

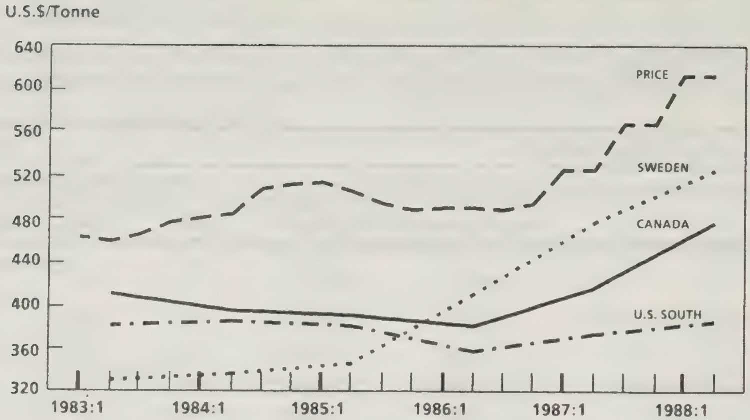
Resource-Based Manufacturing

Resource-based manufacturing includes pulp and paper, wood products and primary metals. This sector accounts for 15 per cent of Ontario manufacturing output and represents 35 per cent of Canada's resource-based manufacturing output.

In 1988, **pulp and paper** prices, production and profits all continued to rise. At current prices, both kraft pulp and newsprint producers are enjoying substantial profit margins; however, these margins are very sensitive to the exchange rate. At current exchange rates, Canadian producers generally have higher costs than their U.S. competitors; however, their competitive position has improved vis-à-vis Scandinavian producers.

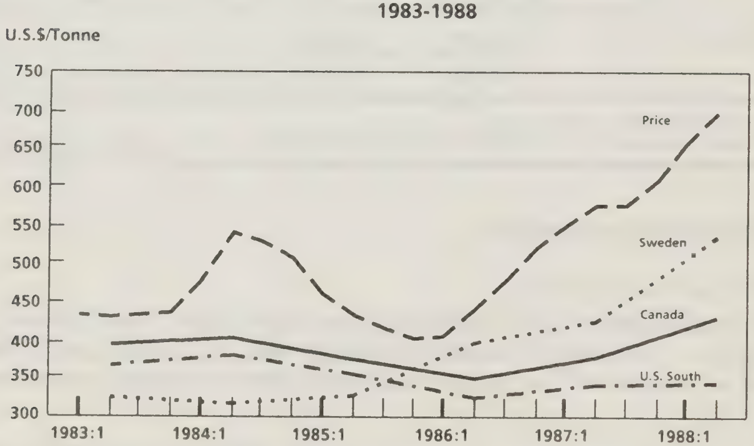
Prices are expected to begin levelling off in 1989. Production is expected to increase only slightly, owing principally to expansion in printing and writing papers at Dryden and Sault Ste. Marie. Beyond 1989, prices are expected to fall as new North American production capacity temporarily outstrips demand growth.

NEWSPRINT PRICE AND PRODUCTION COSTS 1983-1988



Source: Scotiabank and Papertree Letter.

KRAFT PULP PRICE AND PRODUCTION COSTS 1983-1988



Source: Scotiabank and Papertree Letter.

Ontario sawmills, faced with a 15 per cent tax on softwood lumber exports to the U.S., have directed more of their sales to markets within the province; nonetheless, overall shipments still declined by about 2 per cent in 1988. Waferboard producers are also facing difficulties as a result of new capacity in North America, which has depressed prices.

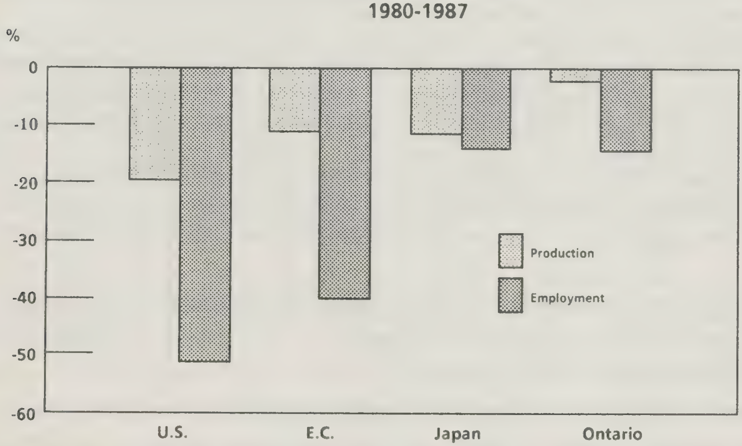
A further decline in housing starts in both Ontario and the U.S. and the rise in the Canada/U.S. exchange rate since mid-1987, will adversely affect the **wood products** industries in 1989. Slow growth is expected in the 1990-92 period.

Higher base metal prices are providing a strong stimulus to the **primary metals** industry whose major components are the iron and steel industry and nickel and copper smelters. In the short-term, a healthy expansion in production is expected. Over the medium term, this sector will record more modest rates of growth.

Ontario's **steel** manufacturing facilities have become some of the most modern and efficient operations in the world. The worldwide downsizing of the steel industry throughout the 1980s has had a much smaller impact on production and employment levels in Ontario than in the U.S. and other OECD countries.

Dofasco's purchase of Algoma Steel makes it the largest steel producer in the country and the fourth largest in North America. Dofasco, which is operating at capacity, will gain access to Algoma's excess steel-making capabilities and an opportunity to expand its product lines.

REDUCTION IN RAW STEEL PRODUCTION AND EMPLOYMENT FOR SELECTED COUNTRIES 1980-1987



Source: Statistics Canada, American Iron and Steel Institute, O.E.C.D. and Ontario Ministry of Treasury and Economics.

In an environment of growing domestic demand, tight supply, and rising industry prices and profits, Ontario's steel producers are enjoying another year of vigorous activity. While output will remain high, slower rates of economic growth, declining use of steel and a tapering off in construction sector demand will result in little expansion over the 1989-1992 period.

Industrial Products

Industrial product manufacturers include electrical and electronic products, machinery, fabricated metals, non-metallic minerals (for example, cement, concrete, clay, glass), plastics, chemicals and petroleum refining. They account for about 40 per cent of manufacturing production in Ontario and 57 per cent of the national total.

As a result of continued economic expansion, modernization in many industries, healthy profit growth and strong business investment spending, the level of real

economic activity in the industrial products sector expanded by an estimated 4.7 per cent in 1988. Growth is expected to continue over the medium term.

Growth in the **electrical and electronic products** sector is being driven by buoyant construction and business investment and the need to modernize production facilities and improve productivity. As a result, sales have been strong for producers of household appliances, office, store and business machines and lighting fixtures. However, with softening in consumer expenditures and housing sector activity and the higher exchange rate affecting both exports and imports, growth is expected to moderate.

The **machinery** industry has rebounded strongly since the recession. In 1987, machinery producers experienced strong demand, with real shipments advancing by about 10 per cent. Machinery sales in 1988 have been helped by increasing levels of business investment in plant and equipment. Also, strength in the resource sector bodes well for makers of mining equipment and pulp and paper machinery. However, overall sales growth will moderate as business investment spending moderates over the forecast period.

The strong advance in shipments by **fabricated metal** manufacturers in 1987 has eased this year. Output of structural and architectural metal products, stamped, pressed and coated products, as well as production from machine shops, is being bolstered by strength in the construction and automotive sectors and the boom in machinery and equipment outlays. Over the medium term moderate growth is forecast. Industry segments that are more closely linked to non-residential business investment will outperform segments dependent on housing sector activity.

The rapid pace of growth experienced by **non-metallic minerals** in the last two years is expected to become more moderate over the forecast horizon as growth in residential construction activity slows.

Plastics will continue to register above average growth over the medium term. In addition to normal demand growth, technological innovation will allow plastics to replace traditional materials in a variety of applications.

The dramatic turnaround in the profitability of the **chemicals** industry, which began in 1986, continued through 1987 and 1988. The petrochemicals industry has been particularly strong. This sector was hard hit by the recession and massive additions to capacity in major oil-producing countries.

The industry is now benefitting from extensive worldwide rationalization and rising demand. Overall capacity utilization is close to 95 per cent in Canada and for certain intermediate and final products it is nearing 100 per cent. As well, the realignment of international currencies has strengthened the competitive position of North American firms in world markets. The rise of the Canadian dollar vis-à-vis the U.S. dollar over the past year has begun to exert competitive pressure on some Canadian firms, particularly in the organic chemicals and specialty chemicals sector. On the whole, however, the industry is expected to maintain satisfactory levels of profitability.

Demand for refined **petroleum products** continued to increase in 1987 and 1988, though more slowly than the economy as a whole. While demand has increased

due to Ontario's population growth and economic expansion, growth has been dampened by continued conservation efforts and the substitution of alternative fuels, mainly natural gas, in heating applications.

As a consequence of the extensive capacity rationalization of the early 1980s, plant utilization rates remain high, at around 92 per cent. With minor investments, capacity should be adequate to meet demand over the next three to four years. Demand is anticipated to grow at about 1 per cent per year over this period. The industry is expected to advance investment plans in order to meet the December 1, 1990 deadline for the elimination of lead additives from automotive gasoline.

Transportation Equipment

The transportation equipment industry is composed of motor vehicle assembly and parts, other transportation equipment (such as airplanes, buses, and railway equipment), and rubber products. Ontario produces about 80 per cent of the national output in this sector. Transportation equipment contributes about 20 percent of Ontario's manufacturing output.

Motor vehicle assembly and parts dominate the transportation equipment industry; they account for over two-thirds of provincial output and employment in the sector. Ontario exports 80 per cent of its motor vehicle production, and has a greater export orientation than either Japan (52 per cent) or the U.S. (8 per cent).

Ontario's **auto production** declined during 1986 and 1987 as a result of shutdowns for plant conversions, slower than anticipated start-ups at several new plants, and a slowdown in U.S. sales during 1987.

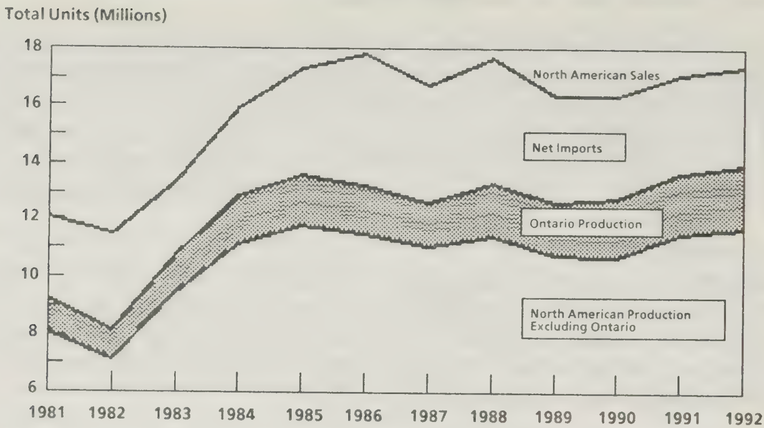
For 1988, Ontario production of motor vehicles has rebounded to a record level, reflecting both higher sales of North American built cars and increased production capacity in Ontario.

The effect of a softening of U.S. vehicle sales during the latter part of 1989 is expected to be largely offset by increasing output from Ontario's new and cost-efficient plants.

During 1988, imports declined as a share of North American sales. This was the result of both expanded production by offshore owned capacity (primarily Japanese production in North America) and the impact of currency realignments. In the medium term, North American auto production is forecast to increase in line with a gradual recovery in North American sales and some improvement in North America's trade balance with the rest of the world.

The improving trade balance is the result of currency realignments and auto industry investments in North America, especially in Ontario, which have greatly enhanced competitiveness. Increased production from North American transplants and joint ventures will displace some imports, and, in some cases, lead to increased exports to Europe and Japan. Ontario production of cars and trucks is expected to exhibit good growth, as Ontario will continue to increase its share of North American production.

ONTARIO AND NORTH AMERICAN MOTOR VEHICLE PRODUCTION 1981 -1992



Source: Ward's Automotive Reports and Ontario Ministry of Treasury and Economics.

Since the health of the Ontario **motor vehicle parts** industry is directly tied to the level of North American motor vehicle production, it, too, experienced significant growth in output and employment following the downturn in the early 1980s. However, the auto parts industry is undergoing considerable restructuring in response to shifts in production technologies and methods and increased international competition.

The Ontario motor vehicle parts industry is expected to grow over the next several years along with North American vehicle production expansion. The industry is benefitting from its orientation to the rapidly growing Canadian assemblers. However, with a higher Canadian dollar, parts industry growth will be somewhat slower than in the recent past.

Recent closures of major tire plants have reduced output in the **rubber industry** in 1988. Lost output will be regained when new investments in plant and technology come on stream, such as Goodyear's new $320 million plant in Napanee. These investments are expected to lead to renewed growth in the industry over the 1990-92 period.

In the **non-automotive transportation equipment** sector, aircraft manufacturing is expected to grow strongly as airlines replace aging equipment.

Consumer Products Industries

Consumer products industries include food and beverages, textiles and clothing, household furniture, and printing and publishing. Ontario produces 48 per cent of the national output in this sector. Consumer products constitute 22 per cent of total provincial manufacturing. Consumer products industries are forecast to increase output by an average of 2.4 per cent annually between 1988 and 1992.

The performance of the **food processing** sector this year will be partially affected by the poor harvest. Assuming a more normal harvest next year, production

should rebound. Output is closely tied to population growth. As a result, relatively slow growth is expected to continue.

The **beverage** industry has exhibited moderate growth, somewhat faster than population trends. This is expected to continue for the medium term. Alcoholic beverages will show the least growth, due to a continued market decline for the spirits industry.

The **tobacco manufacturing** industry has completed a major restructuring and downsizing and is expected to show only modest declines over the next four years.

As a result of a concentrated modernization program, the Canadian **textile industry** is among the most technologically up-to-date in the world. Over the past decade, this modernization has reduced Ontario's textile employment by 8 per cent, while production has grown by 86 per cent. As the economy grows at a more moderate pace in the medium term, the textile industry, including fabrics for clothing, furniture, drapes, and carpeting, is expected to grow more slowly.

By contrast, employment in the **clothing** industry has grown by 23 per cent over the last ten years, with the most rapid growth in Eastern Ontario and the Toronto area. Future prospects are for slower growth, reflecting more restrained spending by consumers, and constraints on industry expansion because of a tight labour market.

Near record house construction, renovations, and healthy office furniture exports to the U.S. have helped Ontario's **furniture and fixture** output grow by 5.6 per cent a year in the 1985-88 period. Future growth is expected to moderate in line with slower household and business spending.

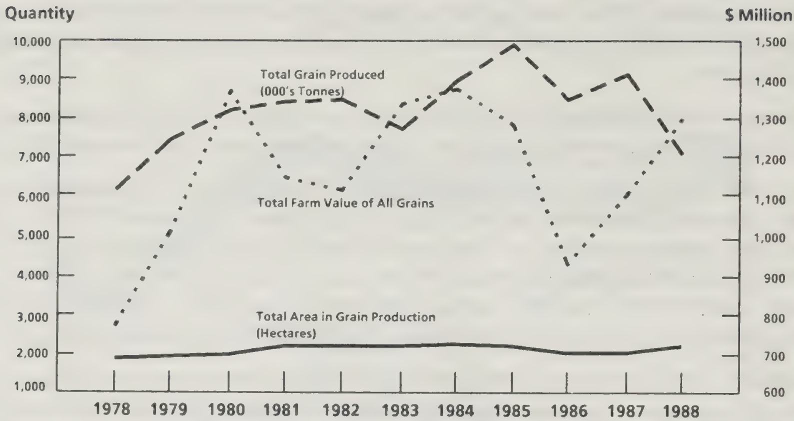
In the last four years, the **printing and publishing** industry has been growing at 4.6 per cent per year. The outlook is for continued growth. Competition from the explosion of in-house photocopying, printing and desktop publishing will result in continued emphasis on cost reduction and technological improvements.

Primary Sector Outlook

Agriculture

Drought in the major producing areas of the U.S., Western Canada and Southwestern Ontario has had a significant impact on agriculture. Total real output in 1988 is expected to be down by 3.8 per cent from 1987, primarily as a result of a substantial decline in grain production.

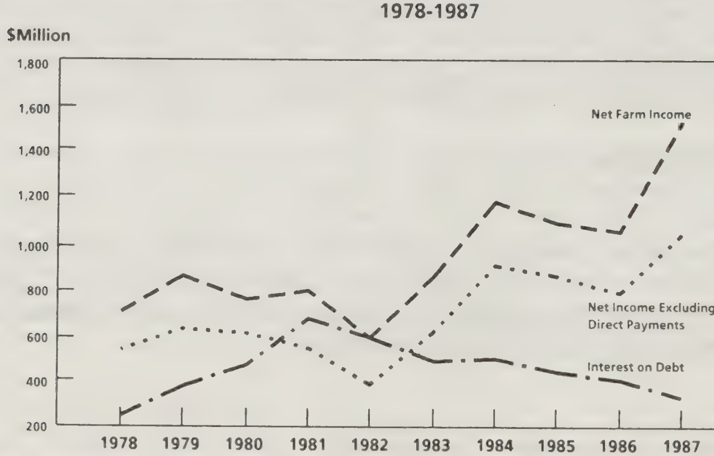
ONTARIO GRAIN PRODUCTION: AMOUNT, AREA AND FARM VALUE 1978-1988



Source: Statistics Canada, Ontario Ministry of Agriculture and Food and Ontario Ministry of Treasury and Economics.

However, higher prices for grains brought about by the drought will result in an increase in receipts for grain shipments as well as for total gross farm revenues in 1988. These higher revenues should further support the trend towards reduced debt and debt servicing costs.

ONTARIO NET FARM INCOME AND THE COST OF DEBT 1978-1987



Source: Statistics Canada.

Over the next four years, real agricultural output is expected to grow at an average annual rate of 2.7 per cent.

In 1989, cereal and oilseed production should show an increase as farmers respond to higher prices and given a return to more typical growing conditions. Over the

medium term, a return to large world grain surpluses and lower prices may be expected.

Red meat production should remain reasonably constant at least until late in the outlook period, when declining feed costs and rising red meat prices should encourage some expansion in the industry.

No real growth in fruit and vegetable production is expected. This is primarily due to import competition, labour shortages and a planned reduction in grape acreage under a joint federal-provincial program.

The 1988 target for the Ontario tobacco harvest is 141 million pounds, up from 110 million pounds in 1987. Stronger domestic prices, foreign demand and a three-year purchasing accord with tobacco manufacturers will help stabilize the industry.

Forestry

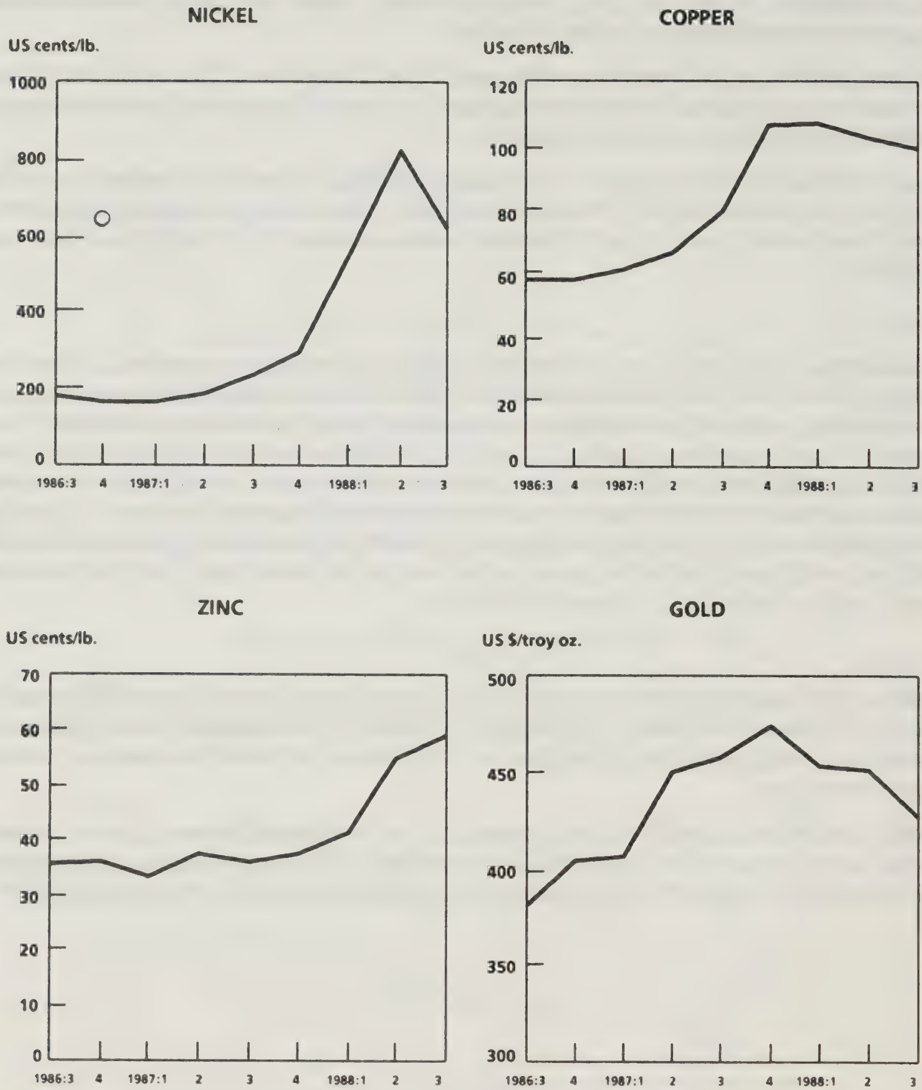
Roundwood production by Ontario's logging industry is expected to decline slightly from the 1987 peak of some 26.4 million cubic meters. Increased demand for wood by pulp mills in 1988 was more than offset by decreased demand from sawmills and waferboard mills. In an effort to reduce costs, mills have also been reducing mill-yard wood inventories in the past few years.. Logging activity was also curtailed by forest fires in much of Northern Ontario this year. A further reduction in logging activity is expected in 1989, as demand by pulp mills levels off, and additional cutbacks occur in the output of sawmills. Over the medium term, logging activity is expected to stabilize.

Mining

While gold has dominated mining news for the past several years, base metal markets showed the most improvement in 1988. Unexpectedly strong demand, combined with limited supplies, has led to substantial price increases for nickel, zinc and copper.

Employment in Ontario's mining industry, after declining for many years, showed significant increases in the first nine months of 1988: exploration employment increased by 52, mine development by 505, and mining by 517, for a total of 1,074.

METALS PRICE PERFORMANCE
1986-1988



Source: Energy, Mines and Resources Canada.

Although gold prices trended downward during 1988, production costs at most Ontario mines are in the range of U.S. $150-$300 per ounce, well below gold's current price of about U.S. $420 per ounce. Eight new gold mines have come into production in the past two years; several others are under development or in the advanced exploration stage. Gold production increased by some 15 per cent this year, and will increase further in 1989.

With 1988 nickel prices about double last year's levels, nickel will again be Ontario's most important mineral. Robust demand from domestic stainless steel manufacturers and Pacific Rim countries should ensure continued strength in 1989.

Zinc market conditions are favourable as demand for galvanized steel remains strong and supplies are tight. Minnova's Winston Lake mine started up in 1988 and will be one of the few new additions to world zinc capacity until mid-1990. Copper should continue to experience increasing demand in 1989, but price increases will be held back by supply increases in the U.S. and Chile.

While uranium prices changed little during 1988, western world consumption exceeded supply for the first time in several years, suggesting improving market conditions.

In general, the medium term outlook for metals is favourable, reflecting continued global economic expansion.

Construction Sector Outlook

The construction sector has enjoyed very rapid growth in recent years. The industry has benefitted from the strong demand for housing and from commercial and industrial developments. Since 1985, employment in construction has grown by over 50,000 jobs -- an increase of 23 per cent. The industry's real output is estimated to have increased by 30 per cent from 1985 to 1988.

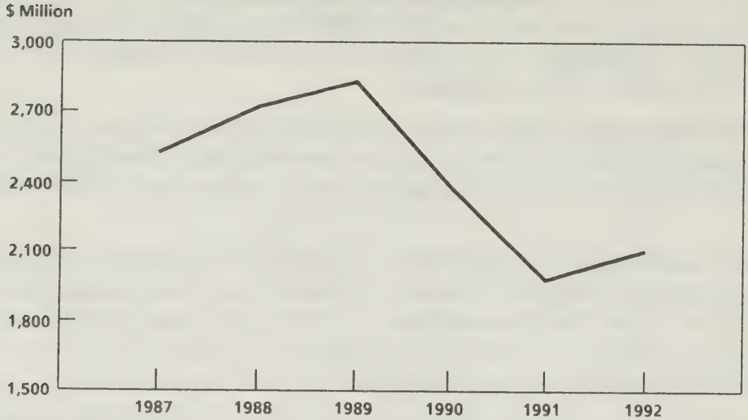
In 1989, business investment will continue strong, and real growth in the construction sector will match growth for the economy as a whole. Over the period 1990 to 1992, slower economic growth, the stabilization of housing starts and a reduced backlog of commercial and industrial projects will reduce construction industry growth to a rate slightly below that of the overall economy.

Utilities Sector Outlook

The utilities sector, composed mainly of electricity generation and gas distribution companies, is closely aligned with the energy requirements of the economy. The utilities sector output is expected to grow modestly over the forecast horizon, reflecting the more moderate growth in population, household formation, and the overall economy.

Investment is dominated by Ontario Hydro, which accounted for roughly 80 per cent of total investment in the utilities sector over the past five years. With the near completion of four units at the Darlington Nuclear Station, investment in electricity generating facilities will decline gradually to 1991. With the completion of Darlington, Ontario Hydro's installed capacity will increase to 33,952 megawatts, compared to 30,087 in 1988.

ONTARIO HYDRO'S CAPITAL INVESTMENT OUTLOOK
1987-1992



Source: Ontario Hydro.

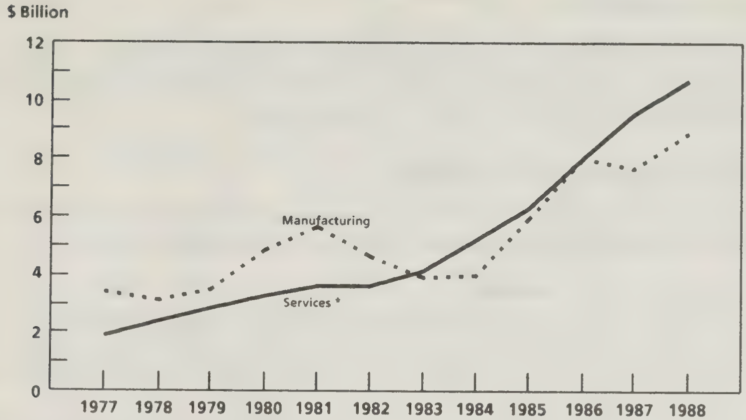
Service Sector Outlook

Many different kinds of businesses and activities make up the service sector, including banking, retail stores, health care, education, trucking, television stations and accounting. Taken as a whole, these activities comprise the largest component of the provincial economy. Output from services is now 61 per cent of total Ontario output. Employment in services is 68 per cent of all Ontario employment.

In recent years, growth of service sector output has been roughly comparable to the growth in output for the goods-producing sector. Service sector industries are less strongly cyclical than goods-producing industries. Consequently, as the economy moves to slower growth in 1989, service sector output growth is expected to be somewhat stronger than output growth for goods-producing industries. However, over the period from 1990 to 1992, service sector output growth will once again approximately match growth for the economy as a whole.

Expenditures on buildings and machinery by the service sector are an increasingly important part of total business investment. Until the early 1980s, capital expenditures in manufacturing exceeded by a significant margin those for a key group of service industries -- trade, finance and commercial services. Since 1983, this position has been reversed. Estimated capital expenditures in Ontario for 1988 are $8.9 billion for manufacturing and $10.7 billion for trade, finance and commercial services.

**CAPITAL EXPENDITURES IN MANUFACTURING AND KEY SERVICES IN ONTARIO
1977-1988**



* **Trade, Finance and Commercial Services.**

Source: Statistics Canada.

As well, service sector industries are as active as manufacturers in taking advantage of new technologies. In 1985, 13 per cent of manufacturing expenditures on machinery and equipment were for computers and robotized equipment. Sixteen per cent of expenditures by the finance, trade and commercial services sector were in these high-technology categories.

Productivity growth has tended to be relatively slow in the service sector. However, given the recent investment performance of service industries and their adoption of new technologies, the productivity performance of the service sector should improve over time.

Tourism Sector Outlook

Tourism is a major generator of employment, accounting for 4.2 per cent of Ontario jobs. The industry is expected to continue to perform well in 1989, generating some $9.8 billion in tourist expenditures. This follows an exceptionally strong performance over the past three years. International currency realignments will encourage further expansion in the overseas market this year, while there may be some reduction in the number of visitors from the United States.

Demographic and consumer trends point to continued expansion in the tourism market over the medium term. Continued real income increases in industrial countries will result in steady growth of personal and business travel. Ontario is well positioned with its good image, diverse society, strong economy and unique natural attractions, to compete for a larger share of this global market.

Ontario Fiscal Review

Revenue Profile*

As of September 30, 1988, it is estimated that Provincial revenues will amount to over $36.2 billion. This section provides a brief overview of Ontario's revenue structure and describes some of its key characteristics.

Composition of Provincial Revenues

The Province has a broad range of revenue sources including taxation, transfer payments from the federal government and other budgetary revenue.

The three major taxation sources -- personal income tax, retail sales tax and corporations tax -- contribute approximately 63 per cent of estimated 1988-89 budgetary revenue. Taxation of gasoline and diesel fuels contributes a further 4 per cent. In total, 71 per cent of 1988-89 revenue will be raised through taxation.

Transfer payments from the federal government account for 15 per cent of 1988-89 revenue. Due to federal actions that shift program costs and responsibilities to the provinces and federal limitations on the growth of Established Programs Financing transfers, this share shows a decline from 23 per cent of revenues in 1978-79.**

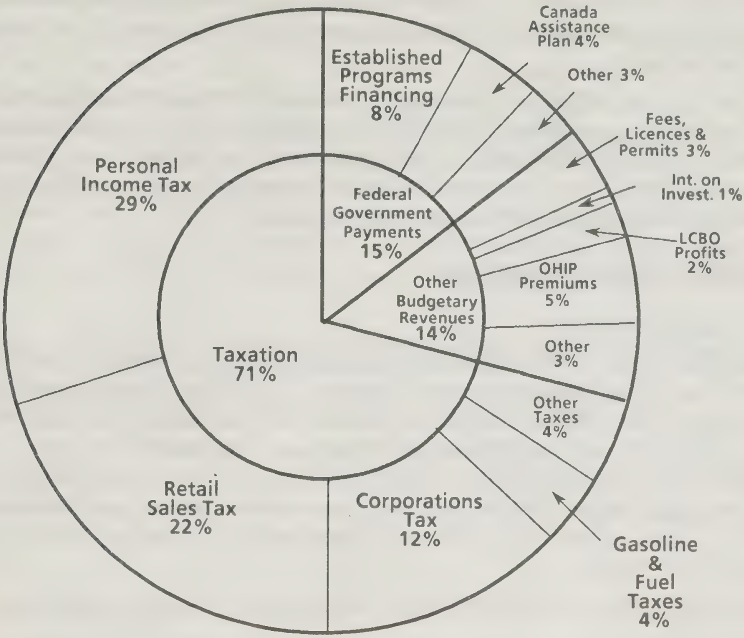
Other revenue sources include OHIP premiums, fees and licences, LCBO profits, interest on investments and lottery profit revenue. These sources will contribute 14 per cent of this year's revenue.

The following chart shows the Ontario budgetary revenue structure.

* All Ontario revenue figures for 1988-89 are based on the September 30, 1988 Ontario Finances.

** Includes $288.6 million one-time federal transfer for shared-cost economic package.

COMPOSITION OF ONTARIO BUDGETARY REVENUES
1988-89*



* Forecast as of September 30, 1988.

Source: Ontario Ministry of Treasury and Economics.

Canadian Tax Reform

In 1987 the federal government's White Paper on Tax Reform outlined two broad proposals for tax reform in Canada: reform of income taxes and reform of sales taxes. The federal government decided to pursue these reforms in two stages.

Stage I, corporate and personal income tax reform, was implemented this year. Central to these reforms is a reduction in the number and value of deductions and exemptions available to individuals and corporations, the conversion of certain exemptions and deductions to credits, and a reduction in tax rates. In addition, the ten personal income tax brackets have been reduced to three.

The 1988 Ontario Budget contained Ontario's response to Stage I. The effects of tax reform would have been to reduce provincial revenues and to impair the ability of some manufacturing and technology industries to compete. In response, Ontario adjusted its rates of personal income tax and increased the Ontario surtax on personal income tax payable in excess of $10,000 . In effect, the surtax applies only to individuals with incomes in excess of $85,000. To improve corporate competitiveness, Ontario introduced a Current Cost Adjustment for manufacturers and a Super Allowance for research and development. Also in response to reform, the Province redesigned its Ontario Tax Reduction and Ontario Tax Credit Programs.

Ontario, the other provinces, the territories and the federal government are engaged in discussions concerning a federal proposal for a joint national sales tax (Stage II of tax reform). Under this proposal, a new tax on value-added would replace the current federal Manufacturers' Sales Tax and the existing provincial retail sales taxes.

A working group of federal-provincial-territorial officials continues to examine the national sales tax option. Ontario is assessing the appropriateness of this option based on a variety of criteria. An important consideration is that the Province would be giving up a mature and well-administered retail sales tax which generates over one-fifth of Provincial revenues.

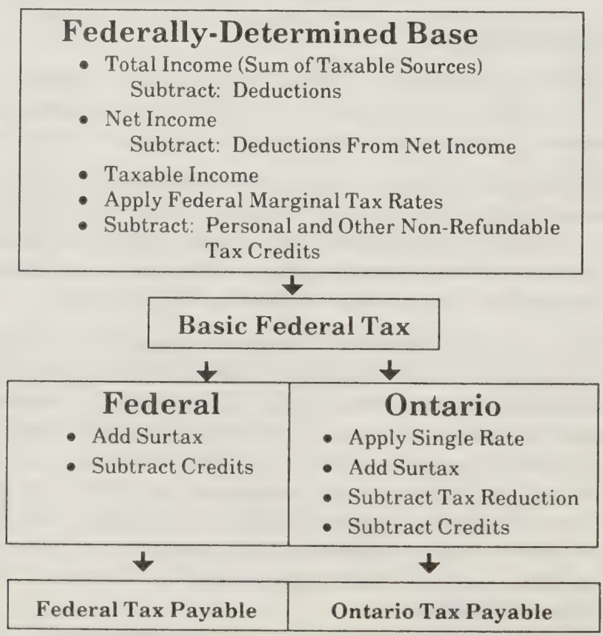
The Major Taxation Sources

Personal Income Tax

Under the terms of the Tax Collection Agreement between the Government of Canada and the Government of Ontario, the federal government collects and administers the Ontario personal income tax on behalf of the Province. The federal government determines the tax base by establishing the definition of taxable income. Basic Federal Tax is calculated by applying the federal marginal rate structure to the taxable income base and deducting specified non-refundable credits. Total federal tax is then determined by applying federal surtaxes and other federal credits.

The diagram below illustrates the calculation of federal and Ontario personal income tax payable.

THE PERSONAL INCOME TAX SYSTEM



The federal marginal tax rates for 1988, including the 3 per cent federal surtax, range from 17.51 per cent on income in the lowest bracket to 29.87 per cent on income in the highest tax bracket.

Ontario personal income tax is defined as a percentage of Basic Federal Tax. For 1988, based on a statutory rate of 51 per cent of Basic Federal Tax, Ontario's personal income tax rates on taxable income range from 8.67 per cent to 14.79 per cent. The Provincial structure is shown in Table 1. In addition, a surtax of 10 per cent is applied to Ontario tax in excess of $10,000. The Ontario surtax increases the top combined federal and Ontario marginal tax rate of 44.66 per cent to 46.14 per cent. At the other end of the income scale, the Ontario Tax Reduction Program eliminates Ontario income tax payable of $150 or less for low-income taxpayers. Ontario income tax accounts for roughly one-third of an individual's total income tax.

Federal and Ontario Marginal Personal Income Tax Rates, 1988 — **Table 1**

Taxable Income	Basic Federal Rate	Federal PIT Rate*	Ontario PIT Rate**	Combined Federal/Ontario PIT Rates
$	%	%	%	%
Up to 27,500	17.0	17.51	**8.67**	26.18
27,501 - 55,000	26.0	26.78	**13.26**	40.04
Over 55,000	29.0	29.87	**14.79**	44.66

* Includes the 3% federal surtax.
** Does not include the Ontario Tax Reduction or the Ontario surtax.

With a few exceptions, such as social assistance payments and lottery winnings, all sources of income are subject to tax. Deductions and non-refundable tax credits are provided for certain personal and income-earning expenses. Provisions in the personal income tax system also support investment and saving for retirement as illustrated in the section on tax expenditures. Appendix I highlights the major tax expenditures* for these and other activities.

The Province provides special programs to relieve tax burdens on low-income Ontarians. Under the enriched $40 million Ontario Tax Reduction Program, as redesigned in response to federal tax reform, 350,000 low-income taxfilers will pay no Ontario income tax this year. There is no comparable federal tax reduction for low-income taxpayers. In addition, Ontario provides refundable property and sales tax credits through the Ontario Tax Credit (OTC) program. As a result of 1988 design changes, the new property and sales tax credits will deliver $444 million in tax credit benefits to over 1.8 million low-income Ontarians to ensure fairer property and sales tax burdens. Sales tax credits have been set at $100 per adult and $50 per child, more than doubling the total benefits for low-income households under this program last year. The combined net income of spouses and supporting individuals in a household will be used as the test for benefit eligibility under the OTC program. This improves fairness and progressivity by shifting

* Tax expenditures are specific incentives in the tax structure that reduce the normal amount of tax paid to a lower or zero amount. The value of a tax expenditure is calculated as the revenue foregone.

benefits from relatively higher income households to lower income households. Over 95 per cent of these tax credit benefits are received by Ontarians with incomes under $30,000.

Corporate Taxes

The Province of Ontario levies the following taxes specifically on the corporate sector: Corporations Income Tax, Capital Tax and Insurance Premiums Tax. Mining companies are also subject to the Mining Tax. All corporations in Ontario, with the exception of insurance companies, are required to pay capital tax based on their paid-up capital. Small corporations with taxable capital under $2 million pay zero or reduced capital tax but all larger corporations must pay tax on capital employed, regardless of income tax paid. The capital tax ensures that a minimum amount of corporate tax is paid by all large Ontario corporations. Insurance companies pay insurance premiums tax based on the amount of premiums received in respect of Ontario policies. Capital taxes and insurance premiums taxes are deductible expenses for federal and Ontario corporate income tax purposes.

The largest source of corporate tax revenue is the Corporations Income Tax. Ontario sets its own corporations income tax base and rate structure for the Province. Although significant differences have existed from time to time, Ontario's current base essentially parallels the federal corporate income tax base. Tax is imposed on gross corporate revenues earned in the taxation year less allowable expenses. Various corporate activities and investments receive special treatment through lower rates or accelerated deductions. These measures are estimated for corporations and listed in Appendix I.

The 1988 general corporations income tax rate is 15.5 per cent of taxable income. Income from manufacturing and processing operations, mining, logging, farming and fishing is taxed at the rate of 14.5 per cent. The 1988 small business tax rate in Ontario is 10 per cent.

The three-year exemption from Ontario corporate income tax for eligible small businesses is being phased out. Corporations that were carrying on active business prior to April 21, 1988 will continue to be exempt from income tax for their first three taxation years. The exemption will be discontinued for corporations incorporated after April 20, 1988.

Along with Ontario, Alberta and Quebec administer their own corporations income tax. All other provinces have entered into tax collection agreements with the federal government.

Retail Sales Tax

The retail sales tax is payable on the sale of most goods and on certain services. The tax is calculated as a specific percentage of the retail price to the consumer. The general retail sales tax rate is 8 per cent. Three other rates apply to specific goods and services: 5 per cent on transient accommodation; 10 per cent on admission fees over $4 and beverage alcohol products sold at licensed establishments; and 12 per cent on beverage alcohol products sold at retail outlets.

A number of goods are specifically exempt from retail sales tax. Exempt items include groceries, energy used for heating, cooking and lighting, children's clothing, footwear costing $30 or less, prescription drugs, specified reading material and production machinery and equipment. Most services are excluded from the retail sales tax base. The major retail sales tax expenditures are listed in Appendix I.

The Province determines both the retail sales tax base and rates. Registered vendors collect the tax as agents of the Province and remit it to the Government.

Motive Fuel Taxes

Ontario levies tax on motive fuels under the authority of two Acts: the Gasoline Tax Act and the Fuel Tax Act. Under both Acts, the tax base is applied to conventional petroleum-based products. Non-conventional fuels such as natural gas, propane, alcohol (used alone or blended with another fuel) and other manufactured gases are exempt.

Fuel taxes are levied on a per litre basis. The Provincial tax is 9.3 cents per litre on unleaded gasoline and 12.3 cents per litre on leaded gasoline purchased in Ontario. This tax applies to fuel used in licensed motor vehicles, snowmobiles and marine pleasure craft. Fuels used for heating and cooking and for off-road use in farming, commercial fishing and for industrial, commercial and institutional purposes qualify for exemption or full rebate of tax.

All aviation fuels purchased in Ontario are subject to a tax of 1.88 cents per litre.

Diesel fuel purchased in Ontario for use in licensed on-road motor vehicles is subject to tax of 9.9 cents per litre. As with the gasoline tax, certain off-road uses qualify for a full rebate of tax paid or are exempt at the time of purchase. A system of fuel colouration is in place to distinguish diesel fuel sold for exempt purposes, such as farming.

A tax of 3.1 cents per litre is applied to diesel fuel purchased in Ontario to power railroad locomotives.

Per Point Yields

Table 2 shows the 1988-89 estimated revenue yield of selected taxes on a per point basis. The estimated yields are based on a full year's revenue and in each case the tax points relate to a specific base and unit of tax, such as percentage point of tax or litre of gasoline. For example, one percentage point of the general retail sales tax is estimated to yield approximately $915 million.

Estimated Per Point Yield, 1988-89 **Table 2**
($ Million)

Retail Sales Tax (RST)			
8%	- General	915	per percentage point
5%	- Transient Accommodation	13	per percentage point
10%	- Alcohol (Licensed Establishments) and Admission Fees	17	per percentage point
12%	- Alcohol (Retail Outlets)	28	per percentage point
All RST rates		**973**	**per percentage point**
Personal Income Tax (PIT)			per percentage point
8.67%	- Taxable Income up to $27,500	1,061	per percentage point
13.26%	- Taxable Income of $27,501 to $55,000	229	per percentage point
14.79%	- Taxable Income over $55,000	106	per percentage point
All PIT rates		**1,396**	**per percentage point**
Ontario (PIT) Surtax		10	per percentage point
Corporate Income Tax (CIT)			
15.5%	- General	97	per percentage point
14.5%	- Manufacturing and Processing, Mining, Fishing, Logging and Farming	88	per percentage point
10%	- Small Business	70	per percentage point
All CIT rates		**255**	**per percentage point**
Capital Tax		165	per 1/10 point
Tobacco Tax		10	1¢ per pack of 20
Motive Fuel Taxes			
Gasoline & Aviation Fuel		143	1¢ per litre
Road and Rail Diesel		38	1¢ per litre
All Fuel tax rates		**181**	**1¢ per litre**
OHIP Premiums (Individual and Family)		59	per $1/$2 a month
Land Transfer Tax (LTT)			per 1/10 point
0.5 % on first $55,000		19	per 1/10 point
1.0% between $55,000 and $250,000		38	per 1/10 point
1.5% above $250,000 (single family dwellings only)		3	per 1/10 point
All LTT rates		**60**	**per 1/10 point**

Note: See text for interpretation of these data.
Source: Ontario Ministry of Treasury and Economics.

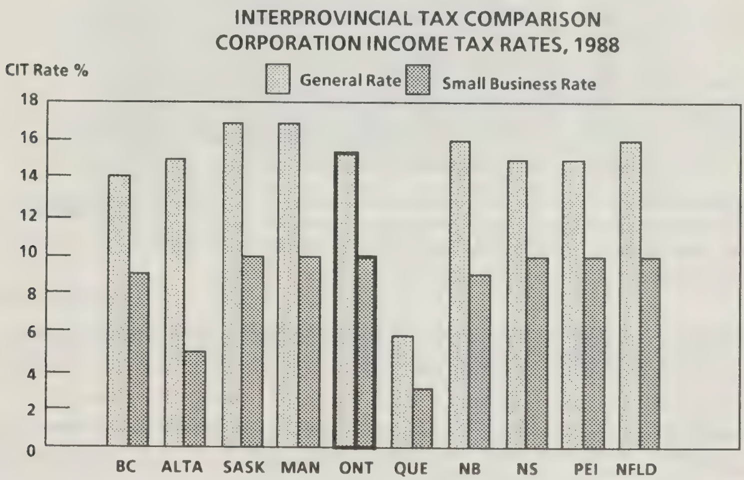
Interprovincial Tax Rate Comparisons

Interprovincial tax rate comparisons must be viewed with caution. Differences in taxable bases are particularly important in interprovincial comparisons and are best illustrated by comparing the application of the retail sales tax. Significant interprovincial differences in retail sales tax exemptions exist for clothing, footwear, prepared food products, heating fuels and electricity, and transient

accommodation. Interprovincial differences also exist in the CIT treatment of various activities. For example, in respect of incentives for research and development, Ontario provides an extra deduction, called the Super Allowance, while Quebec provides tax credits. In the PIT area, some provinces apply tax credits, flat taxes, or surtaxes which affect both marginal and effective tax rates.

Corporation Income Tax

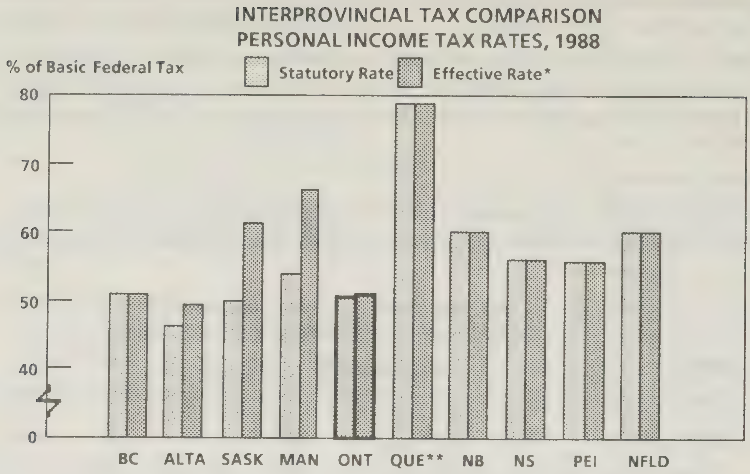
As illustrated in the following chart, Ontario's general and small business corporate income tax rates are comparable with those in most Canadian provinces.



Source: Ontario Ministry of Treasury and Economics.

Personal Income Tax

Provincial personal income tax rates and provincial personal income tax revenues as a percentage of Basic Federal Tax are illustrated below. Ontario's effective rate is 51.3 per cent, when the Ontario Tax Reduction Program and surtax are taken into account.



* Effective rate is total provincial income tax revenue (including any surtaxes and flat taxes, less any tax reductions) as a percentage of basic federal tax assessed in the province.

** Estimated rate; Quebec does not impose tax as a percentage of Basic Federal Tax.

Source: Ontario Ministry of Treasury and Economics and provincial tax statutes.

Table 3 shows the provincial and combined federal-provincial top marginal personal income tax rates for 1988. Ontario has the third-lowest top marginal tax rate.

Top Marginal Personal Income Tax Rates, 1988 — Table 3

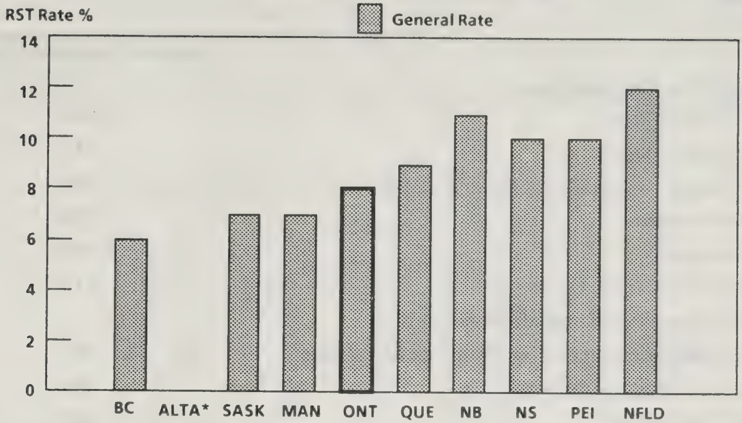
	B.C.	Alta.	Sask.	Man.	Ontario	Quebec	N.B.	N.S.	P.E.I.	Nfld.
Provincial	14.9	15.1	18.5	19.7	**16.3**	26.0	17.4	16.4	17.1	17.4
Combined federal-provincial	44.8	44.9	48.4	49.5	**46.1**	51.1	47.3	46.3	46.9	47.3
Rank	1	2	8	9	**3**	10	6	4	5	6

Source: Ontario Ministry of Treasury and Economics.

Retail Sales Tax

General retail sales tax rates in Canada range from zero per cent in Alberta to 12 per cent in Newfoundland. Ontario's rate of 8 per cent is in the mid-range of rates applied by all taxing jurisdictions.

INTERPROVINCIAL TAX COMPARISON
RETAIL SALES TAX RATES, 1988



* No provincial sales tax is imposed.

Source: Ontario Ministry of Treasury and Economics and provincial tax statutes.

Tax Expenditures

Tax expenditures are taxes that governments choose not to levy in order to redistribute income more fairly or to encourage individuals and corporations to undertake desired activities. As such, tax expenditures are exceptions to the normal tax rules. Tax expenditures are often used as alternatives to direct spending to achieve particular policy objectives.

There are four types of tax expenditures: exemptions, deductions and allowances, credits, and special reduced rates of tax. All four are in use in Ontario's tax system.

Table 4 lists the ten largest tax expenditures within Ontario's jurisdiction, along with an estimate of revenue foregone for each expenditure. However, because many of these tax expenditures are interdependent, economists agree that these estimates should not be added together to derive a total value of foregone revenue. A more complete list of Ontario's major tax expenditures, along with a brief description of each, is contained in Appendix I.

Ten Largest Tax Expenditures Within Ontario's Sole Jurisdiction in 1988-89 **Table 4**
($ Millions)

	Ontario Revenue Foregone
Retail Sales Tax Expenditures	
Professional Services	3,657
Commercial Services	2,011
Energy Goods	1,687
Personal Services	1,682
Basic Groceries	1,102
Production Machinery Goods	818
Personal Income Tax Expenditures	
Ontario Health Insurance Plan Premium Assistance*	770
Ontario Tax Grants to Seniors*	471
Ontario Tax Credits**	444
Corporate Income Tax Expenditures	
Small Business Deduction	385

* Although not directly part of the Personal Income Tax system, these tax expenditures provide benefits to individuals.

** Personal Income Tax expenditures are based on 1988 taxation year.

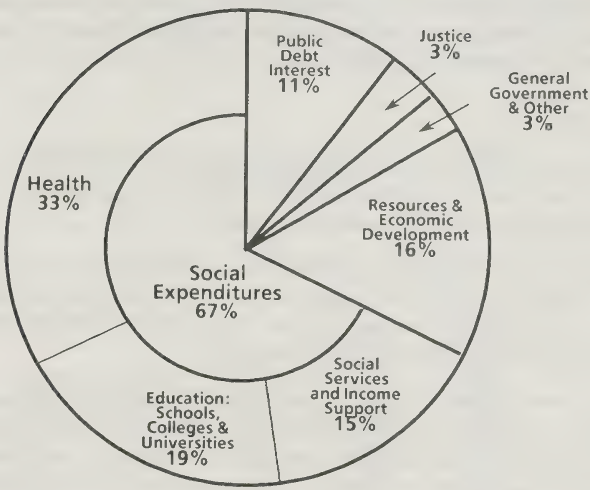
Source: Ontario Ministry of Treasury and Economics.

Expenditure Profile

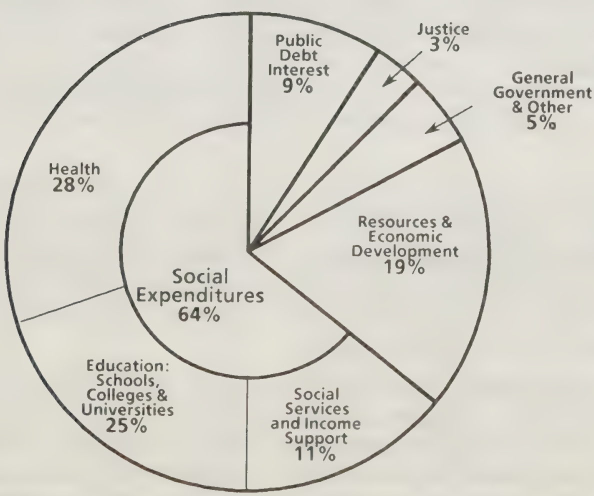
As of September 30, 1988, it is estimated that Provincial expenditures will amount to $37.9 billion in 1988-89. More than two-thirds of all Provincial spending is on social programs, with the balance allocated to economic development, justice, public debt interest, and other government activities. The charts below illustrate the proportion of government spending by major expenditure area in 1988-89 and 1978-79.

DISTRIBUTION OF ONTARIO'S EXPENDITURES

1988-89



1978-79



Source: Ontario Ministry of Treasury and Economics.

The charts indicate that there has been an appreciable shift in the composition of Provincial expenditures. The dominant feature of this shifting pattern is a notable

increase in the share of spending allocated to health care. The Ministry of Health is expected to account for 33 per cent of expenditures in 1988-89, compared to 28 per cent in 1978-79.

The proportion of Provincial spending allocated to social services and income support has also increased significantly. This area represented 11 per cent of spending in 1978-79, and accounts for 15 per cent of expenditures in 1988-89.

While an increasing share of expenditures is being taken up by health and social services and income support, the expenditure shares for education and for resources and economic development are being compressed. Education expenditures represented 25 per cent of Provincial spending in 1978-79, and are estimated to be 19 per cent in 1988-89. The share of Provincial spending dedicated to resources and economic development has fallen from 19 per cent in 1978-79 to an estimated 16 per cent in 1988-89.

Health Care

The increasing share of spending dedicated to health care is of particular fiscal importance because it has influenced and will continue to affect the resources available for all other Provincial programs.

In the period from 1978-79 to 1988-89, health care expenditures increased at an average annual rate of 12 per cent. After allowing for population growth, which averaged 1 per cent per annum over the period, per capita health spending increased at a rate of 11 per cent per year.

The largest components of the overall health care program are the Operation of Hospitals, the Ontario Health Insurance Plan (OHIP) and the Ontario Drug Benefit Plan (ODB). In 1988-89 these three programs will account for 80 per cent of Ministry of Health expenditures. A more detailed look at health care funding is provided in Appendix II.

Expenditures for the Operation of Hospitals, the largest component of health care expenditures, increased at an average annual rate of 11 per cent over the 1978-79 to 1988-89 period. Spending has more than doubled from \$2.0 billion to \$5.5 billion. The share of the Ministry of Health budget dedicated to the Operation of Hospitals has declined, however, from 50 per cent in 1978-79 to 43 per cent in 1988-89.

OHIP costs have increased at an average annual rate of 15 per cent over the period, quadrupling total OHIP outlays from \$1.0 billion in 1978-79 to \$4.0 billion in 1988-89 and increasing the program's share of Ministry of Health expenditures from 26 per cent to 32 per cent. Rising utilization and an average annual 3.3 per cent increase in the number of physicians over the past ten years were contributing factors to this increase.

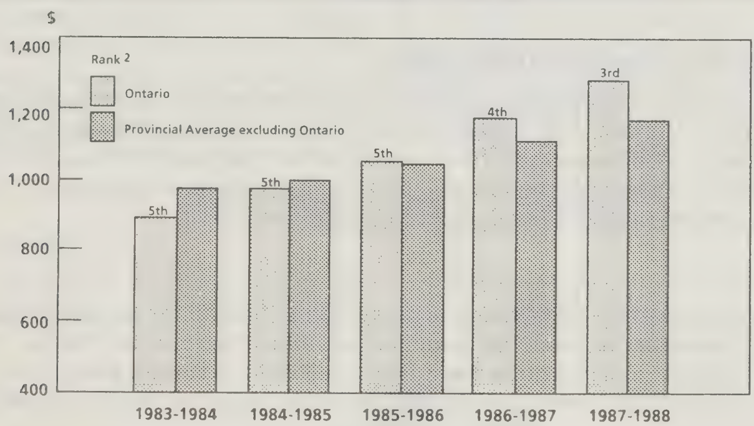
One of the most rapidly growing components of health care costs is the Ontario Drug Benefit Plan. Ministry of Health expenditures on the ODB plan increased from \$89 million in 1978-79 to \$569 million in 1988-89. The share of Ministry of Health expenditures allocated to ODB increased from 2 per cent to 5 per cent over the period. One factor accounting for this fast growth has been a rapid increase in the size of the eligible population. There are 35 per cent more seniors aged 65 and

over in the province in 1988 compared to 1978. An additional factor has been the sharply increasing average cost of claims.

The rapid rate of increase in health care expenditures in Ontario has resulted in a marked increase in Ontario's per capita health expenditures relative to per capita health spending in the other provinces. The following chart shows per capita health spending in Ontario compared to the average spending in the other nine provinces over the 1983-84 to 1987-88 period.

In 1983-84, Ontario's per capita health spending, at $896, was about 9 per cent below average spending in other provinces of $979 per capita. By 1987-88, however, Ontario's per capita level was $1,285, about 9 per cent above the average of $1,175 per capita spent in the other nine provinces. The higher rate of increase in Ontario compared to other provinces has resulted in Ontario's rank in per capita health spending increasing from fifth highest in 1983-84 to third highest in 1987-88.

PROVINCIAL HEALTH CARE SPENDING [1] PER CAPITA
1983-84 TO 1987-88



1 Combined Provincial and Local government sectors.
2 Ontario's rank among provinces, from highest to lowest.
Source: Statistics Canada

Transfer Payments

Almost three-quarters of the Government's expenditures, or $27.8 billion, are transfer payments to third parties such as hospitals, school boards, universities and municipalities. The principal components of these transfers are listed below.

1988-89 Transfer Payments		Table 5
	$ Billion	% of Spending
Five Major Transfers		
Hospitals	5.5	14.5
Colleges	0.7	1.7
Universities	1.6	4.1
School Boards	3.9	10.3
Municipalities	4.2	11.0
Other Transfers		
OHIP	4.0	10.6
ODB	0.7	1.8
Other	7.3	19.4
Total Transfer Payments	27.8	73.4

Note: May not add due to rounding.
Source: Ontario Ministry of Treasury and Economics.

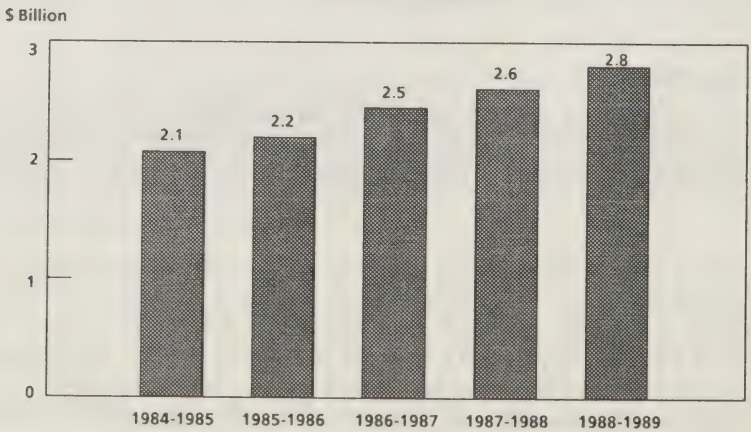
Non-Transfer Payment Expenditures

The 26.6 per cent of expenditures which are not in the form of transfer payments amount to $10.1 billion. More than $4.0 billion of non-transfer payments will be spent on public debt interest. The remaining $6.1 billion will fund institutions operated by the Province, such as psychiatric hospitals and correctional facilities, and other government programs, including administration.

Capital

In total, approximately $2.8 billion is provided in 1988-89 for capital investments, including investments made by transfer payment recipients. Since 1984-85, Provincial capital expenditures have increased at an average annual rate of 6.6 per cent. The graph below shows the level of capital expenditures in recent years.

CAPITAL EXPENDITURES
1984-85 TO 1988-89



Source: Ontario Ministry of Treasury and Economics.

Spending Control

Savings and Constraints Measures

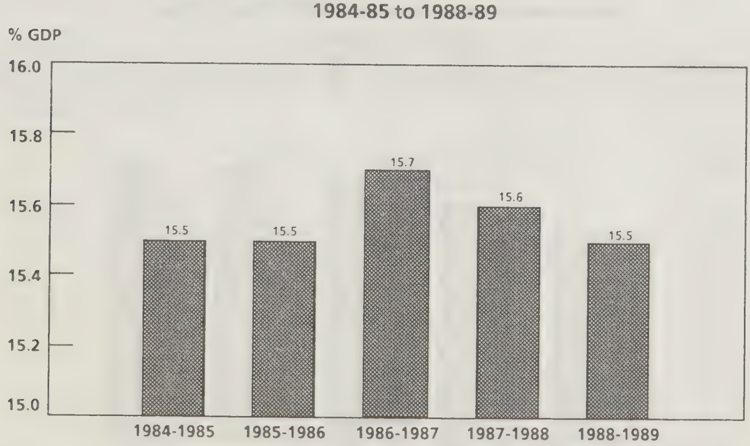
The 1988-89 Budget contained a provision for a Government-wide $500 million expenditure savings and constraints program. This measure was part of the Government's continuing efforts to control spending and improve the efficiency of program delivery. In the 1987-88 fiscal year, $350 million in savings were achieved in this way.

This year, every Ministry contributed to the savings and constraints goal through across-the-board reductions in total salaries and benefits of two per cent and reductions in non-payroll expenditures of six per cent. In addition, some ministry-specific reductions were applied to general program areas based on reduced cash flow requirements.

Expenditure Growth

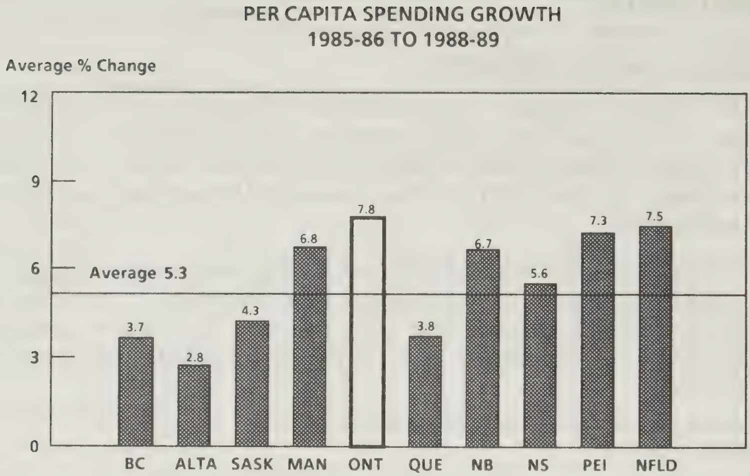
In each of the past two years, the Province's growth in expenditures has been held below the rate of growth in the economy. In 1987-88, expenditures grew at 8.6 per cent compared to a 9.7 per cent increase in nominal GDP. In 1988-89, expenditure growth is forecast at 8.4 per cent compared to 9.2 per cent growth forecast for nominal GDP. These trends have resulted in a decline in expenditures as a share of Gross Domestic Product.

EXPENDITURE AS A SHARE OF THE ECONOMY
1984-85 to 1988-89



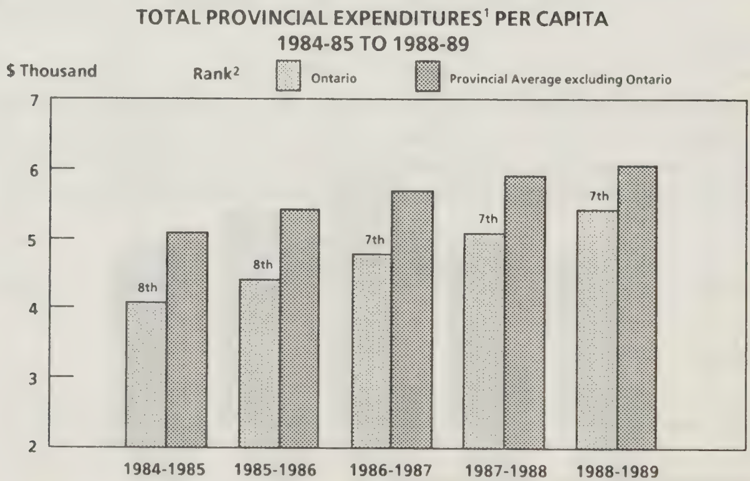
Source: Ontario Ministry of Treasury and Economics.

Relative to other provinces, Ontario has had the highest rate of growth in per capita expenditures over the past four years. From 1985-86 to 1988-89, the all-province average annual rate of per capita expenditure growth has been 5.3 per cent, compared to Ontario's average rate of 7.8 per cent.



Source: Ontario Ministry of Treasury and Economics.

Despite high rates of expenditure growth, the level of total per capita expenditures in Ontario remains below the average level of other provinces, ranking Ontario 7th among the provinces in per capita spending. Faster expenditure growth in Ontario is narrowing this spending gap, however. This trend is shown in the following chart.



[1] Combined Provincial and Local government sectors.

[2] Ontario's rank among provinces, from highest to lowest.

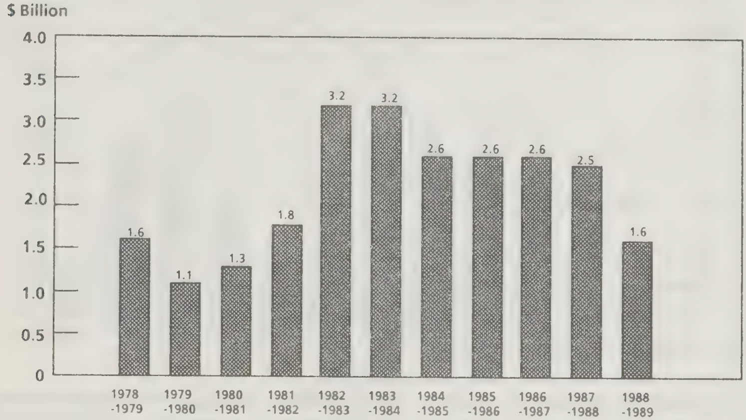
Source: Ontario Ministry of Treasury and Economics.

Fiscal Indicators

Ontario's fiscal trends can be assessed in terms of commonly used indicators. The following section evaluates the fiscal position of the province.

Ontario's deficit rose to a level of more than $3.1 billion in 1982-83, but since that time has declined to $2.5 billion in 1987-88, and is forecast to be $1.6 billion in 1988-89, a reduction of almost $900 million from the previous year.

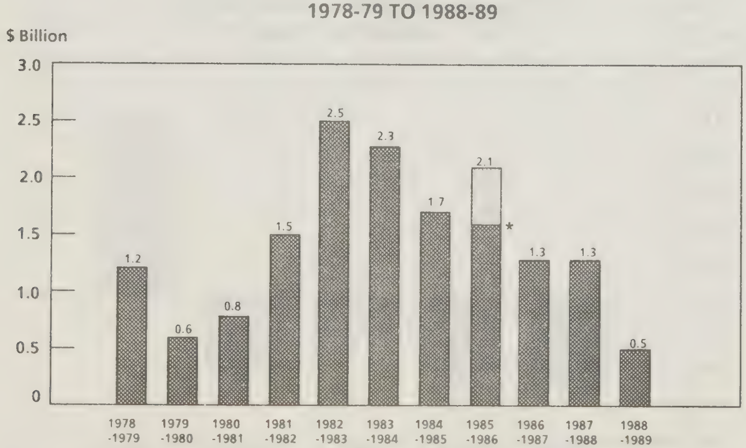
ONTARIO DEFICIT
1978-79 TO 1988-89



Source: Ontario Ministry of Treasury and Economics.

Net cash requirements have been reduced from the $2.5 billion peak level reached in 1982-83 to $1.3 billion in 1987-88, and are expected to decline to an estimated $482 million in 1988-89.

ONTARIO NET CASH REQUIREMENTS
1978-79 TO 1988-89

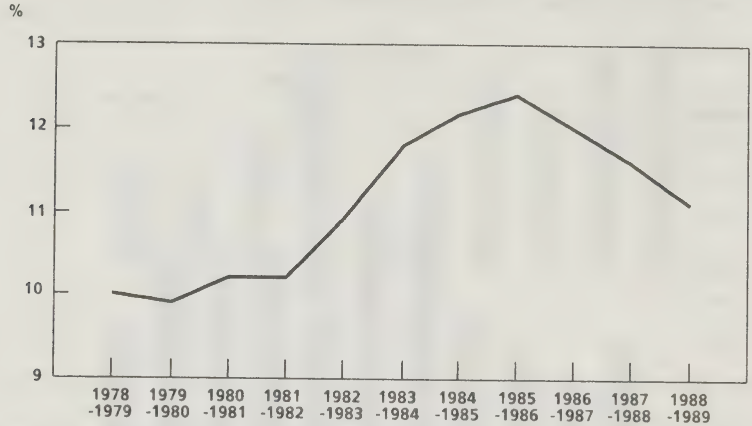


* **Excludes extraordinary adjustments of $0.5 billion.**

Source: Ontario Ministry of Treasury and Economics.

Ontario's public debt interest costs will exceed $4.0 billion in 1988-89, requiring 11.1 per cent of revenues. By contrast, federal public debt charges in 1988-89 are currently forecast at 31 per cent of federal budgetary revenues. The Ontario proportion continues its downward trend from a high of 12.4 per cent in 1985-86.

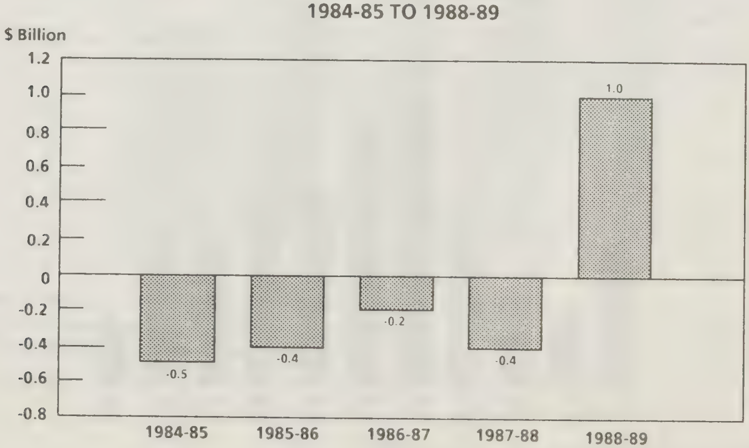
PUBLIC DEBT INTEREST AS A PERCENTAGE OF REVENUE
1978-79 TO 1988-89



Source: Ontario Ministry of Treasury and Economics.

Ontario's operating position reflects the Province's ability to pay for day-to-day operating needs from current revenues. Current expenditures exclude spending on capital investments, while current revenues exclude one-time cash flow increases associated with the federal government's acceleration of personal income tax transfers. In 1988-89, Ontario's operating position will be in a surplus of almost $1 billion. This surplus will contribute towards the funding of more than $2.8 billion in capital expenditures this year.

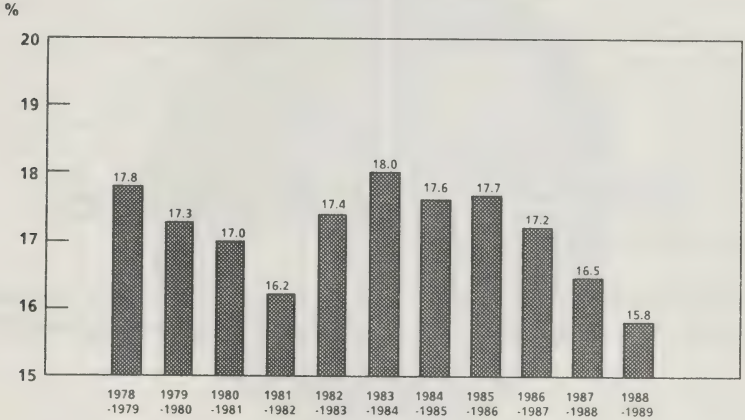
ONTARIO OPERATING POSITION
1984-85 TO 1988-89



Source: Ontario Ministry of Treasury and Economics.

Ontario's total accumulated own purpose debt is expected to be $38.8 billion by the end of 1988-89. Measured as a share of the economy, the debt burden has moderated in the past five years. From a peak of 18.0 per cent of provincial Gross Domestic Product in 1983-84, the debt declined to 16.5 per cent in 1987-88. In 1988-89, debt as a share of the economy is expected to decline further to 15.8 per cent, the lowest proportion achieved since 1974-75.

TOTAL OWN-PURPOSE DEBT AS A SHARE OF THE ECONOMY 1978-79 TO 1988-89

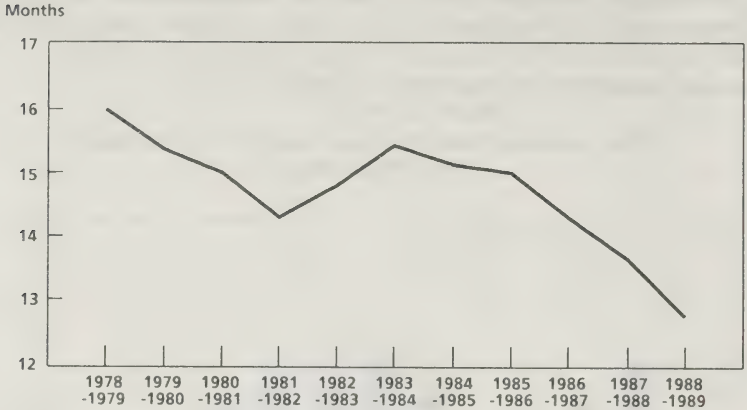


Source: Ontario Ministry of Treasury and Economics.

As of March 31, 1988, the Province has in addition accumulated $7.5 billion of debt on behalf of Ontario Hydro. The Province has also guaranteed $17.5 billion of Ontario Hydro's borrowing.

Another fiscal indicator used as a measure of Ontario's ability to carry its total own-purpose debt is the number of months of revenue that would be required to repay this debt. This number has fallen steadily in the past five years, from 15.4 months in 1983-84 to 13.7 months in 1987-88. In 1988-89, it is expected to fall further to 12.8 months, lower than in any other year since 1970-71.

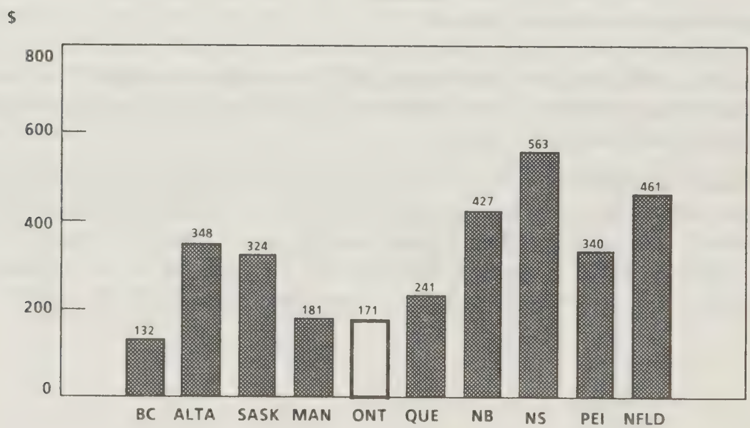
MONTHS OF REVENUE TO REPAY TOTAL DEBT
1978-79 TO 1988-89



Source: Ontario Ministry of Treasury and Economics.

On an interprovincial basis, Ontario's fiscal performance compares favourably. At $171 per person, Ontario will have the second lowest deficit per capita in 1988-89.

DEFICITS PER CAPITA
1988-89

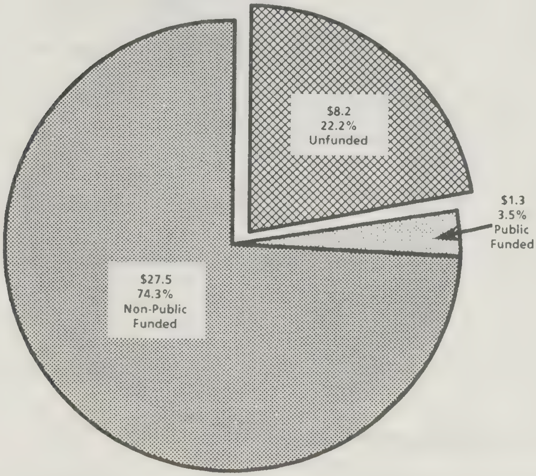


Source: Ontario Ministry of Treasury and Economics.

Debt and Debt Financing*

Ontario's Debt

COMPOSITION OF ONTARIO'S OWN-PURPOSE TOTAL DEBT
MARCH 31,1988
($BILLION)



Source: Ontario Ministry of Treasury and Economics.

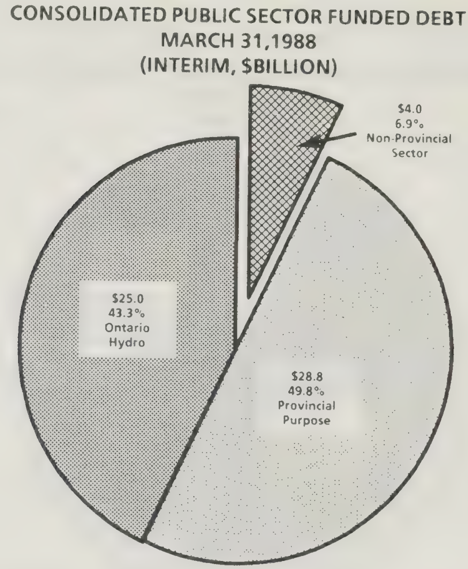
Ontario's own-purpose total debt consists of funded and unfunded debt. Own-purpose total debt amounted to $37 billion as of March 31, 1988.

Funded debt, the largest portion, has a specified term to maturity and is secured by a debt instrument such as a bond or Treasury Bill. Ontario's funded debt is concentrated in non-public debt, owed primarily to the Canada Pension Plan (CPP) and the Teachers' Superannuation Fund (TSF) in the form of long-term, non-marketable securities at market-related rates of interest. Debt owed to the general public constitutes 3.5 per cent of the Province's total debt. The Province's estimated funded debt at March 31, 1989 will be $29.6 billion of which about 90 per cent will be owed to the CPP and TSF.

Unfunded debt refers to obligations that are not secured by a debt instrument, such as deposits with the Province of Ontario Savings Office and for the Public Service Superannuation Fund (PSSF). Unfunded debt represents 22.2 per cent of Ontario's total debt, up from 16 per cent ten years ago. Ontario's own-purpose total debt will be about $39 billion by the end of fiscal 1988-89 compared to $18.1 billion ten years ago.

*All Ontario debt figures for 1988-89 are based on the September 30, 1988 Ontario Finances.

Consolidated Public Sector Funded Debt



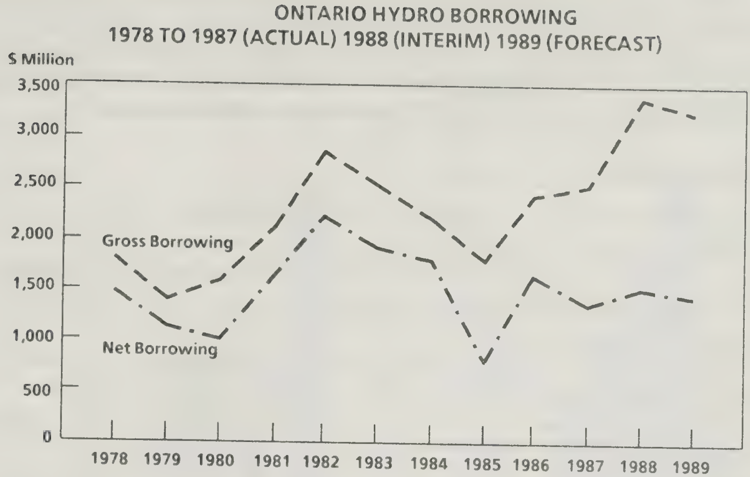
Source: Ontario Ministry of Treasury and Economics.

The broadest measure of funded debt in the Ontario Public Sector is Consolidated Public Sector Funded Debt, which includes debt incurred at all levels of Provincial jurisdiction. As of March 31, 1988, Consolidated Public Sector Funded Debt is estimated to have reached $57.8 billion.

The preponderance of Provincial and Provincially-guaranteed debt in this measure illustrates Ontario's practice of centralizing public sector financing at the Provincial level. Ontario's direct and guaranteed funded debt, which is over 90 per cent of the consolidated debt, consists of obligations for the Province's own purpose or for Ontario Hydro. Due to Ontario's practice of centralized financing, there is a limited requirement for public borrowing by local bodies, colleges and hospitals. Internal funds and Provincial grants finance a large proportion of local capital expenditures, with the remainder financed by borrowing. Local government debt is about 4 per cent of consolidated funded debt while less than one-half of one per cent consists of the obligations of universities, colleges and hospitals. The Provincial (direct and guaranteed) share of Consolidated Public Sector Funded Debt has been rising over time, reflecting the centralized approach to financing.

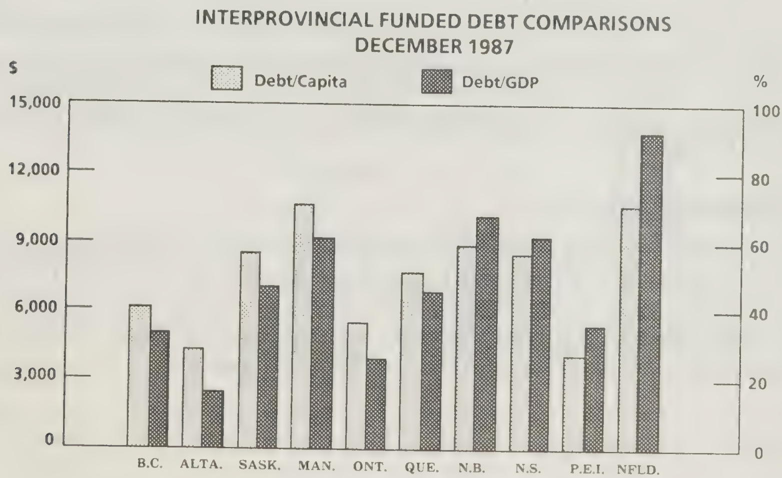
Hydro Borrowing

In 1988 and 1989, Ontario Hydro's annual gross borrowing is expected to be around $3.4 and $3.2 billion, respectively, with borrowing net of retirements amounting to $1.5 billion in 1988 and $1.5 billion in 1989. The Province will continue to monitor Hydro's financing needs and plans to ensure that they are consistent with the Province's fiscal and financing plans.



Source: Ontario Hydro.

Interprovincial Debt Comparison



Source: Bank of Canada Review and Ontario Ministry of Treasury and Economics.

Interjurisdictional debt comparisons usually focus on funded debt measures because this assures a standard of conceptual uniformity and comparability across jurisdictions and over time. Similarly, in order to avoid the inconsistencies caused by provinces assuming different types of debt at different levels of the public sector, the sum of funded debt owed by a province and debt guaranteed by a province is often used in interprovincial comparisons. Nevertheless, the comparisons remain limited by differences in treatment across provinces of sinking funds and purchases by public sector investment funds, such as the Alberta Heritage Savings Trust Fund.

Ontario's direct and guaranteed debt measures are relatively low compared to other provinces. In 1987, Ontario owed $5,458 per person. This was the third lowest level of direct and guaranteed debt per capita in Canada, higher only than Prince Edward Island and Alberta. Ontario had the second lowest level of debt as a per cent of Gross Domestic Product (26.5 per cent), after Alberta.

Ontario's Financing

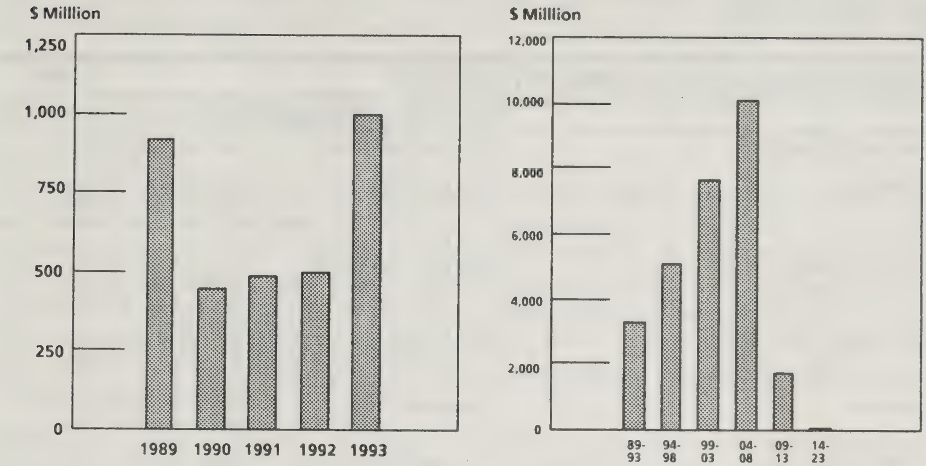
The Province of Ontario has available for its financing purposes the funds of the Teachers' Superannuation Fund (TSF) and Ontario's share of the Canada Pension Plan (CPP), as well as domestic and international capital markets. Because of the structure of contributions and benefits of these two pension plans, they have been a growing source of financing for Ontario. In 1988-89, availability of non-public sources of funds exceeds the Province's needs and, consequently, Ontario will decline the CPP funds available to it. CPP funds not required by the Province have been offered to Ontario Hydro. To date, in 1988-89, the Province has borrowed $523 million from the CPP on behalf of Ontario Hydro. In addition, the 1988 Budget announced that $2 billion of CPP funds would be made available to aid in the provision of 30,000 units of non-profit housing over the next 3-5 years.

Recent reports to the government from Lawrence Coward, on the financing of indexation benefits, from the Task Force on the Investment of Public Sector Pension Funds, and from Dr. David Slater, on consultations held with respect to these issues, have recommended that the investments of the TSF and PSSF be placed in marketable securities rather than non-marketable Provincial debentures and deposits. If these recommendations were accepted, the Province would increasingly meet its financing needs from public market sources, as do most other provinces.

Ontario's Maturing Debt

Approximately 12 per cent of Ontario's funded debt (excluding Treasury Bills) is scheduled to mature in the five-year period from April 1988 to March 1993 and 30 per cent in the ten years from 1989 to 1998. In the five-year period ending March 1993, maturities (excluding Treasury Bills) will total $3.4 billion, with 70 per cent representing retirements of Canada Pension Plan obligations.

ONTARIO DEBT MATURITY



Source: Ontario Ministry of Treasury and Economics.

Credit Worthiness

Provincial Ratings October 1988 — **Table 6**

	Standard and Poor's (S&P)	Moody's	Canadian Bond Rating Service (CBRS)	Dominion Bond Rating Service (DBRS)
British Columbia	AA	Aa2	AA	AA (low)
Alberta	AA+	Aa1	AA	AA
Saskatchewan	AA–	A1	AA–	A (high)
Manitoba	A+	A1	AA–	A (low)
Ontario	AAA	Aaa	AAA	AA
Quebec	AA–	Aa3	A	A (high)
New Brunswick	A+	A1	A	A
Nova Scotia	A–	A2	A–	A (low)
Prince Edward Island	NR*	A3	BBB+	A (low)
Newfoundland	A–	Baa1	BBB	BBB

* Not Rated.

Source: Ontario Ministry of Treasury and Economics, Canadian Bond Rating Service, Dominion Bond Rating Service, Moody's Bond Survey and Standard and Poor's CreditWeek.

Following the economic recession of the early 1980's, nearly all Canadian provinces were downgraded by one or more major credit rating agencies, including Standard and Poor's downgrading of Ontario in November 1985. In the past two years, four western provinces were downgraded and three eastern provinces were upgraded, reflecting the unevenness of economic recovery across Canada. In August 1988, Standard and Poor's restored Ontario's rating to AAA, making

Ontario the only Canadian province assigned Triple A by three credit rating agencies (Standard and Poor's, Moody's and the Canadian Bond Rating Service). The Province shares Dominion Bond Rating Service's highest provincial rating with Alberta (AA).

Rating Adjustments in 1986, 1987 and 1988 — **Table 7**

	Rating Change	
British Columbia	Downgraded from:	Aa1 to Aa2 (Moody's)
Alberta	Downgraded from:	Aaa to Aa1 (Moody's) AAA to AA+ (S&P) AAA to AA (CBRS)
Saskatchewan	Downgraded from:	AA to AA– (S&P) Aa3 to A1 (Moody's) AA to AA– (CBRS)
Manitoba	Downgraded from:	AA– to A+ (S&P) A to A(low) (DBRS)
Ontario	Upgraded from:	AAA– to AAA (CBRS) AA+ to AAA (S&P)
Quebec	Upgraded from:	A1 to Aa3 (Moody's)
New Brunswick	Upgraded from:	A2 to A1 (Moody's)

Source: Ontario Ministry of Treasury and Economics, Canadian Bond Rating Service, Moody's Bond Survey and Standard and Poor's CreditWeek.

Federal-Provincial Funding Programs

The following sections describe the two major programs through which the provinces now receive substantial federal funding: the fiscal arrangements and the Canada Assistance Plan. In addition, the proposed Canada Child Care Act and some implications for Ontario are highlighted.

Federal-Provincial Fiscal Arrangements

Introduction

The federal-provincial fiscal arrangements are the institutional vehicles through which the federal government transfers funds to the provinces as part of its historical commitment to certain national shared-cost programs, and to the principle of interprovincial fiscal capacity equalization. The largest of these payments is made in respect of health care and post-secondary education under Established Programs Financing. Funds are also transferred under the Equalization program, the Fiscal Stabilization program, and the Personal Income Tax Revenue Guarantee.

Although often discussed in terms of federal-provincial negotiation and agreement, the fiscal arrangements are under the sole legislative and administrative control of the federal government. Every five years, legislation in this area is drafted and enacted by the federal government, and requires no provincial enabling legislation, support or even agreement to operate. In practice, however, Ottawa has consulted with the provinces on potential revisions to the legislation prior to enactment.

Established Programs Financing

Adopted in 1977 to replace the federal-provincial shared-cost programs in the fields of health and post-secondary education, Established Programs Financing was regarded as a milestone in co-operative federalism in Canada. The essence of the new arrangement was that the provinces, long dissatisfied with the cumbersome and inflexible nature of the cost-sharing arrangements, were given greater policy and administrative latitude through a move to block funding. At the same time, Ottawa lessened its financial risk by tying its contributions to the rate of growth of the national economy rather than to provincial expenditures.

Shortly after the new arrangement had been agreed upon, the federal government decided to keep track of the individual cash components of the transfers for health and post-secondary education. While not consistent with the principle of block funding, the split was for federal bookkeeping purposes only and did not require provinces to demonstrate that they had, in fact, spent the funds in these areas.

The Canada Health Act passed by Parliament in 1984, sets program criteria and conditions of payment for the cash portion of transfers paid to the provinces for insured health care services and extended health care. Under the terms of the legislation, each province's health insurance plan must satisfy federal requirements respecting comprehensiveness, portability, universality, accessibility and public administration.

The federal government is empowered to withhold a portion of the provincial transfer payments equal to the amount that physicians bill above the rates set out

in the provincial fee schedules. Dollar for dollar deductions are also imposed on provinces that permit user charges. Between July 1984 and June 1986, over $106 million in payments to Ontario were withheld by the federal government. The Province has since complied with the conditions of the Canada Health Act by eliminating extra-billing for insured health services and has recouped the amount withheld.

As shown in Table 8, the federal government has taken a number of further actions to restrain the growth of its payments to the provinces. When the fiscal arrangements were amended in 1982, the Revenue Guarantee Compensation, which was built into Established Programs Financing as part of the 1977 agreement, was removed. This effectively eliminated a portion of the per capita entitlements.

Established Programs Financing transfer growth is based on both growth in the economy and population increases for individual provinces. Under the two-year federal "6 & 5" restraint program introduced in June 1982, per capita limits were imposed on post-secondary education transfer growth.

Most recently, the federal government's Bill C-96, An Act to Amend the Federal-Provincial Fiscal Arrangements and Federal Post-Secondary Education and Health Contributions Act, 1977, received Royal Assent in June 1986. It reduces the annual growth in per capita Established Programs Financing transfers by two percentage points. In 1988-89, Bill C-96 will reduce Ontario's Established Programs Financing entitlements by $395 million. Taken together, the reductions in Established Programs Financing entitlements for Ontario amount to $976 million in 1988-89, and will exceed $1 billion in 1989-90.

Provincial Losses Due To Federal EPF* Cuts Since 1982 **Table 8**
($ Million)

	Elimination of Revenue Guarantee Compensation		"6 & 5" Caps on PSE** Transfers		Reduction of EPF* Escalator		Total
	Ontario	All Prov.***	Ontario	All Prov.***	Ontario	All Prov.***	Ontario
1982-83	293	827	–	–	–	–	**293**
1983-84	323	910	41	117	–	–	**364**
1984-85	354	992	90	253	–	–	**444**
1985-86	382	1,068	98	273	–	–	**480**
1986-87	409	1,139	105	291	114	316	**628**
1987-88	436	1,205	111	308	246	679	**793**
1988-89****	463	1,272	118	325	395	1,088	**976**
1989-90****	494	1,345	126	344	568	1,549	**1,188**
TOTAL	3,154	8,760	690	1,911	1,323	3,632	**5,167**

* Established Programs Financing.
** Post-Secondary Education.
*** Includes Territories.
**** Forecast
Note: Figures may not add due to rounding.
Source: Ontario Ministry of Treasury and Economics
Source: Department of Finance, Canada and Ontario Ministry of Treasury and Economics.

Federal support for Ontario health and post-secondary education programs has fallen from a peak of 52 per cent of provincial-local spending for these purposes in 1979-80 to under 40 per cent in 1988-89.

Equalization

Equalization payments are unconditional transfers from the federal government to qualifying provinces, with the purpose, as enshrined in Section 36 of the Constitution Act, 1982, of ensuring that provincial governments have sufficient revenues to provide "reasonably comparable levels of public services at reasonably comparable levels of taxation". The actual determination of equalization entitlements has evolved over the years by refinements and adjustments to the formula since the inception of the program in 1957. Although there have been disagreements about these changes, some of which have had quite dramatic effects, all provinces have supported the overall thrust of the Fiscal Equalization Program.

Ontario has never been an equalization recipient. Indeed, when oil price shocks created the possibility of Ontario receiving equalization payments, these equalization payments were prevented through a retroactive legislative amendment in 1981.

The current "five-province standard" of fiscal capacity replaced a national average standard in 1982. This change, combined with a number of tax base modifications, tended to disadvantage Quebec and Manitoba. Accordingly, a transitional guarantee was incorporated into the formula. The transitional guarantee provided that no province could receive less under the new formula than it received in the last year of the old formula. Provision was made for a specified amount of growth.

As Table 9 illustrates, all provinces except Alberta, British Columbia and Ontario receive significant federal equalization transfers.

Estimated Equalization Entitlements by Province, 1988-89 **Table 9**

	($ Million)	($ Per Capita)
Newfoundland	844	1,486
Prince Edward Island	172	1,340
Nova Scotia	783	886
New Brunswick	776	1,087
Quebec	3,299	497
Manitoba	635	586
Saskatchewan	288	285
TOTAL	6,798	616

Notes: 1 Figures may not add due to rounding.
2 Ontario, Alberta and British Columbia have net negative entitlements and do not receive equalization payments.

Source: Department of Finance, Canada: Provincial Fiscal Equalization, Second Estimate, 1988-89 (September, 1988).

For 1988-89, the current estimate of total equalization entitlements is $6.8 billion. The sole legislative constraint on the growth of equalization entitlements is that aggregate transfers must not exceed the year over year increase in Gross National

Product (GNP). So far, this ceiling has not had to be applied. Although Quebec receives the greatest share of total equalization, on a per capita basis, it receives the second least.

Fiscal Stabilization

In order to protect provinces from sudden year-over-year losses in revenue resulting from an economic downturn, the federal government has provided for fiscal stabilization payments. These unconditional cash transfers ensure that each province's tax revenues, measured on the basis of constant tax rates and structure, plus its equalization payments, will not be less than they were in the previous year.

In 1987-88, the federal government introduced, among other technical changes, an annual ceiling of $60 per capita for grant assistance. Fiscal Stabilization entitlements exceeding this limit are provided as interest-free loans repayable within five years. To date, only one province has received payments under this program -- British Columbia received $175 million in respect of the 1982-83 fiscal year. However, fiscal stabilization payments provide an important guarantee for many provinces.

Personal Income Tax Revenue Guarantee

Since provinces set personal income tax rates in relation to the basic federal tax, the federal Personal Income Tax Revenue Guarantee provides limited compensation to provinces when federal tax policy changes reduce provincial revenues within a taxation year. Compensation is provided for the amount that personal income tax revenue losses exceed 1.0 per cent of basic federal tax for the province. The only Revenue Guarantee payment made to date has been $4.3 million to Saskatchewan in respect of the 1985 taxation year.

Canada Assistance Plan

The Canada Assistance Plan (CAP) was established by federal legislation in 1966 as a cost-sharing mechanism for provincially-administered social assistance and welfare programs. The Canada Assistance Plan replaced the targetted shared-cost programs that provided assistance for the elderly, the blind, the disabled and the unemployed. By the end of the 1960s, these programs had come under increasing criticism for their eligibility restrictions. The new program was designed to bring a measure of order and coherence to fragmented provincial public assistance systems.

Since its inception, federal payments under CAP increased from $0.3 billion in 1967-68 to an estimated $5.0 billion in 1988-89. This makes CAP the third largest source of transfers to the provinces after Established Programs Financing and equalization. Ontario revenue from CAP is expected to total $1.3 billion for 1988-89.

The Canada Assistance Plan is intended to act as a safety net. Under its provisions, the federal government contributes an amount equal to 50 per cent of provincial expenditures on assistance payments (food, shelter and clothing) to individuals in need, and a range of services, including child welfare, child care, homemaker services for the elderly, institutions for the disabled and family counselling. To qualify for federal CAP funds, provincial programs must be

designed to benefit those "in need or likely to become in need". As well, potential beneficiaries must demonstrate their eligibility through either a needs test or an income test, as determined by each province and subject to federal guidelines.

The Canada Assistance Plan has been the subject of numerous reviews during the last two decades. In 1970-71, the Senate Committee on Poverty issued a report that was critical of CAP and recommended that it be replaced by a guaranteed annual income. Ten years later, negotiations were underway to remove social services from CAP and provide them through a block fund under a proposed Social Services Financing Act modelled on Established Programs Financing. The proposal, however, was withdrawn when the provinces refused to accept a reduction in the Established Programs Financing escalator to GNP growth less one per cent. The proposal to replace the federal share of CAP and other federal tax and transfer programs, such as family allowances and child tax credits, with a guaranteed annual income, was resurrected by the Macdonald Commission in 1985 when it recommended the adoption of a Universal Income Security Program.

More recently, the Nielsen Task Force on Program Review found no support for a major revision of CAP. However, its report did register concern over the trend toward long-term dependence on assistance among "employables" and warned of the danger that future CAP costs may become unaffordable as a result. The Nielsen review concluded that it may be necessary to change the open-ended nature of CAP funding by limiting federal spending under the agreement. However, the Canada Assistance Plan remains a singular example of intergovernmental collaboration and cost-sharing of major social programs available across Canada.

Canada Child Care Act

Provincial child care expenditures for this fiscal year are estimated at $300 million, an increase of 238 per cent from the level of 1984-85.

On September 26, 1988, the House of Commons passed the proposed Canada Child Care Act, draft legislation to enable the federal government to enter into cost-sharing agreements to contribute to provincial child care programs. The Act died during Senate review with the September 30 dissolution of Parliament, and would have to be re-introduced. In all, the federal government has announced a total of $6.4 billion for child care over seven years. Of this amount, $2.3 billion is for tax provisions, $60 million is for special programs for native people, $100 million is for special demonstration and research projects, and $3.9 billion is for contributions to provincial child care programs.

The federal government has offered to replace open-ended contributions to Ontario child care programs with a maximum $1.7 billion in federal program contributions over the 1988 to 1995 period. Subject to annual federal funding limits, Ottawa's contributions would include 75 per cent reimbursements for capital grants for approved not-for-profit child care facilities, as well as 50 per cent reimbursements for operating grants for all approved child care centres.

Provinces also have the option to continue current federal cost-sharing of child care expenditures under the Canada Assistance Plan rather than convert to an arrangement under the proposed Canada Child Care Act.

Provincial-Local Transfers

In 1988-89, the Province will provide close to $4.2 billion in financial support to municipalities and municipal agencies, as indicated in Table 10.

Provincial support to school boards also amounts to almost $4.2 billion, including nearly $238 million in capital assistance.

Highlights of Provincial Transfers to Local Governments **Table 10**
($ Million)

	Outlook 1988-89
Transfers to Municipalities	
Unconditional	874
Roads	685
Transit	340
Social Services	1,367
Health	196
Environmental	142
Recreational & Cultural	90
Other	470
Total Municipal Transfers	4,164
Transfers to School Boards	
General Legislative Grants	3,915
Capital Grants	238
Total School Transfers	4,153
Total Transfers to Local Government	8,317

Source: Ontario Ministry of Treasury and Economics.

Transfers to Municipalities

Transfer payments to municipalities are estimated to increase by 7.7 per cent in 1988-89.

The average annual growth in Provincial support to the municipal sector has significantly outpaced inflation in Ontario over the last five years. As Table 11 indicates, total operating transfers increased faster than the rate of inflation (4.6 per cent) while the growth in capital transfers kept pace with inflation, reflecting the more stable pattern of Provincial capital activity in general.

Provincial Transfers to Municipalities — **Table 11**
($ Million)

	1983-84	Outlook 1988-89	Average Annual Increase (%)
Unconditional	691	874	4.8
Conditional	1,305	2,181	10.8
Total Operating	1,996	3,055	8.9
Capital	899	1,109	4.3
Total Transfers	2,895	4,164	7.5

Source: Ontario Ministry of Treasury and Economics.

Municipal Sector Performance

Municipal spending in 1988 is expected to grow by 11.8 per cent. This growth continues to be led by the areas served by regional governments, excluding Metro Toronto, which account for 40 per cent of municipal spending. These areas are generally experiencing above-average service growth as measured by the growth in households. It should also be noted that individual municipal patterns of growth within these areas can vary considerably. By comparison, Table 12 shows that, for municipalities not within regional governments, spending growth is expected to average only 8.3 per cent.

Estimated Municipal Spending, 1987 & 1988 — **Table 12**
($ Million)

	1987	1988	Increase (%)
Metropolitan Toronto	3,643	4,060	11.4
Other Regional Governments	4,517	5,180	14.7
All Regional Governments	**8,160**	**9,240**	**13.2**
Cities Not Part of Regional Governments	1,595	1,726	8.2
All Other Municipalities	1,701	1,845	8.5
Non-Regional Governments	**3,296**	**3,571**	**8.3**
Total Municipal Sector	**11,456**	**12,811**	**11.8**

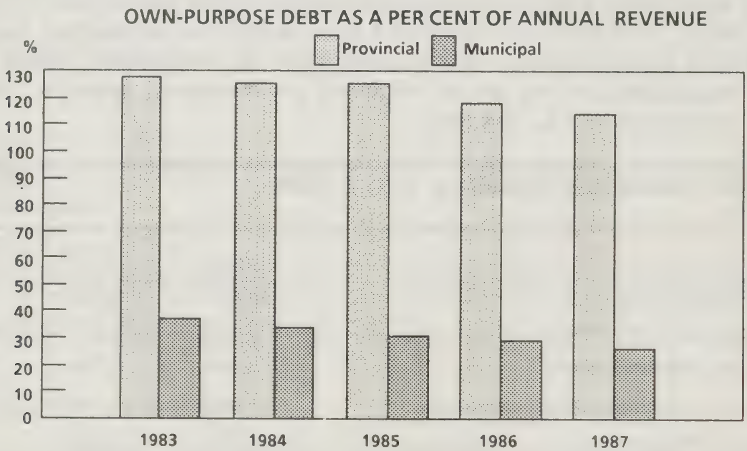
Source: Ontario Ministry of Municipal Affairs.

As shown in Table 13, the proportion of municipal financing accounted for by transfers and municipal property taxes has dropped over the period, with the difference being made up by other revenues, particularly user fees.

Municipal Revenue Mix (Per Cent)		Table 13
	1983	1988
Property Taxation	35.6	35.0
Provincial Grants	32.9	30.7
All Other Revenues	31.5	34.3
	100.0	100.0

Source: Ontario Ministry of Municipal Affairs.

As a group, municipalities are in a better position than the Province with respect to their debt burdens. "Debt" includes total long term debt and sewer and water project debt. In 1987, total municipal own-purpose debt was approximately $3 billion, or about 26 per cent of total annual revenues. By comparison, total Provincial own-purpose debt was 114 per cent of annual budgetary revenue. Public debt interest payments are estimated at about 11 per cent of annual revenues for the Province in 1988 -- higher than the 7 per cent estimated for municipalities.



Sources: Ontario Ministry of Treasury and Economics and Ontario Ministry of Municipal Affairs.

During the last five years, municipalities have, as a group, reduced their reliance on long-term borrowing to finance expenditures. It should be noted there are restrictions on the ability of municipalities to carry an operating deficit. The Ontario Municipal Board provides guidelines for measuring a municipality's ability to take on increased debt. As a general rule, the Board and the Ministry of Municipal Affairs have determined that a municipality should not commit to spend more than 20 per cent of its annual operating revenue on debt servicing. Municipalities retain a significant capacity to assume debt for capital projects or other major requirements. Table 14 below shows the most recent estimates of

municipal capacity to borrow funds, excluding debt assumed on behalf of school boards and Provincially-guaranteed debt.

Estimated Municipal Debt Capacity, 1987 — Table 14
($ Million)

	Total Debt Capacity	Available Debt Capacity $	Available Debt Capacity %
Municipalities within Metropolitan Toronto	3,449	2,847	82.5
Municipalities within Regions	3,317	2,454	74.0
All Regional Governments	**6,767**	**5,301**	**78.3**
Municipalities within Counties	2,281	1,957	85.8
Municipalities within Districts	655	630	96.2
All Non-Regional Governments	**2,936**	**2,587**	**88.1**
Total Municipal Sector	**9,702**	**7,888**	**81.3**

Source: Ontario Ministry of Municipal Affairs.

Education Finance

The funding of elementary and secondary education in Ontario is shared between the Province and local school boards. The Provincial share is distributed to school boards through the General Legislative Grants and capital programs with the school board share being raised from local property taxes. School funding is a significant component of government spending at both levels, as shown in Table 15.

Education Finance in Perspective — Table 15
(Per Cent)

	1988-89
Transfer Payments to School Boards	
Relative to Total Local Transfers	49.9
Relative to Provincial Budgetary Expenditure	11.0
School Finance in the Local Sector	
School Board Operating Spending Relative to Total Local Operating Spending	45.9
Average Residential School Taxes Relative to Total Local Property Taxes*	50.6

* On a per-household basis

Source: Ontario Ministry of Treasury and Economics.

APPENDICES

I. Tax Expenditures

II. Health Care Expenditure Profile

III. Fiscal Capacity and Tax Effort

IV. Glossary of Terms

APPENDIX I

Tax Expenditures

Personal Income Tax Expenditures Estimates of Ontario Revenue Foregone in the 1988 Taxation Year — **Table 1**

($ Million)

	Ontario Revenue Foregone
Tax Expenditures Shared with the Federal Government	
Deductions and Exemptions	
Registered Retirement Savings Plan Contributions	352
Registered Pension Contributions	258
$100,000 Lifetime Capital Gains Exemption	191
Capital Gains Exclusion	106
Carrying Charges	85
Union Dues	59
Child Care Expenses	38
Moving Expenses	9
Non-Refundable Tax Credits	
Basic Personal Credit	2,833
Married Credit (including Equivalent-to-Married)	440
Age Credit	158
Charitable Donations	151
Unemployment Insurance Premiums	150
Canada Pension Plan Contributions	137
Credit for Dependent Children	80
Pension Income Credit	38
Medical Expenses	23
Tuition Fees	22
Education Credit	10
Disability Credit	6
Tax Expenditures Solely Within Ontario's Jurisdiction	
Ontario Health Insurance Plan Premium Assistance	770
Ontario Tax Grants to Seniors	471
Ontario Tax Credits	444
Ontario Home Ownership Savings Plan Tax Credit	30
Ontario Tax Reduction	40
Ontario Political Contribution Tax Credit	5

* **Although not directly part of the Personal Income Tax system, these tax expenditures provide benefits to individuals.**

Source: Ontario Ministry of Treasury and Economics.

Corporate Tax Expenditures
Estimates of Ontario Revenue Foregone in 1988-89
($ Million)

Table 2

	Ontario Revenue Foregone
Corporate Income Tax	
Small Business Deduction	385
Capital Cost Allowance vs. Accounting Depreciation	290
Capital Gains Exclusion	180
Reduced Rate for Specified Sectors	88
Research and Development Super Allowance	32
Exploration and Development Expenses	20
Manufacturing Current Cost Adjustment	10
Allowable Business Investment Losses	1
Small Business Development Corporations Program	0.3
Ontario Mineral Exploration Program	0.2
Resource Allowance*	0
Capital Tax	
Flat Capital Tax for Small Business	94
Farm Equipment Dealers: Capital Tax Reduction	0.3
Mining Profits Tax	
Three-Year Mining Profits Tax Exemption for New Mines	5
$500,000 Mining Profits Exemption	3

* Commences January 1, 1989

Source: Ontario Ministry of Treasury and Economics.

Retail Sales Tax Expenditures **Table 3**
Estimates of Ontario Revenue Foregone in 1988-89
($ Million)

	Ontario Revenue Foregone
Services	
Professional	3,657
Commercial	2,011
Personal	1,682
Transient Accommodation	39
Admission fees	28
Goods	
Energy (including motive fuels)	1,687
Basic Groceries	1,102
Production Machinery	818
Reading Materials	154
Prepared Foods	120
Soil and Water	110
Prescription Drugs	101
Children's Clothing	65
Aircraft	52
Footwear	34
Medical Equipment	26
Feminine Hygiene Products	10
Purchaser Specific - All goods and services tax exempt or tax rebated	
Farmers	190
Visitors to Ontario	23
Hospitals	14
Religious/Charitable	10
Disabled Persons	7
Fishermen	1
Fur-trappers	1
Museums/Galleries	1
Municipalities (fire trucks)	1

Source: Ontario Ministry of Treasury and Economics.

Personal Income Tax Expenditures
1988 Tax Rules

Tax Expenditures Shared with the Federal Government

Deductions and Exemptions

Registered Retirement Savings Plan Contributions - Contributions are deductible from income up to prescribed limits. The allowable contribution for each year is governed by the maximum limit for that year ($7,500 in 1988), the individual's income and the amount of any contributions to a registered pension plan.

Registered Pension Contributions - Employee contributions as required under the pension plan are deductible from income.

$100,000 Lifetime Capital Gains Exemption - Taxpayers are permitted a cumulative lifetime capital gains exemption of $100,000.

Capital Gains Exclusion - One third of capital gains are tax-exempt.

Carrying Charges - Individuals may deduct from income the interest cost on money borrowed to make investments, fees for investment counselling and other investment related expenses.

Union Dues - Annual dues for membership in qualifying organizations are deductible from income.

Child Care Expenses - Expenses paid for child care services that enable single parents or both spouses in a two-parent family to earn income or attend an educational or training program are deductible from income. The maximum deduction is $4,000 for each child under the age of 7 and $2,000 for each child age 7 and over.

Moving Expenses - Unreimbursed moving expenses may be deducted from income by those who move at least 40 kilometres closer to their new workplace.

Non-Refundable Tax Credits*

Basic Personal Credit - A credit of $520 is available to every taxfiler.

Married Credit (including Equivalent-to-Married) - A credit of up to $434 is available to a taxfiler in respect of a dependent spouse, or if not married, in respect of an eligible dependent living with the taxfiler.

Age Credit - The age credit of $281 is available to all taxfilers age 65 and over.

Charitable Donations - A credit is available in respect of charitable donations and for gifts to Canada or a province, or for gifts of cultural property.

Unemployment Insurance Premiums - A credit of up to $60 is available for required premiums.

* The income tax return does not show any amounts for Provincial non-refundable income tax credits. The value of these credits in respect of individual Ontario tax payable has been estimated by multiplying each federal credit by Ontario's tax rate of 51 per cent.

Canada Pension Plan Contributions - A credit of up to $41 is available for required contributions.

Credit for Dependent Children - A credit of $33 may be claimed in respect of each dependent child under age 19, with the credit doubled for the third and subsequent children in the family.

Pension Income Credit - This provision allows individuals, mostly seniors, to claim a credit of up to $87 in respect of their eligible pension income.

Medical Expenses - A credit is available in respect of out-of-pocket medical and dental expenses in excess of 3 per cent of Net Income.

Tuition Fees - A student may claim a credit in respect of eligible tuition fees, with any unused credit portion transferable to a supporting taxpayer.

Education Credit - This credit is for full-time students and is based on the number of months of attendance, with any unused credit portion transferable to a supporting taxpayer.

Disability Credit - This credit of $281 is available to taxpayers who meet prescribed disability criteria.

<u>Tax Expenditures Solely Within Ontario's Jurisdiction</u>

Ontario Health Insurance Plan Premium Assistance - This program eliminates or reduces OHIP premiums for low-income families and specified groups in society.

Ontario Tax Grants to Seniors - Property tax grants of up to $600 and sales tax grants of $50 are available to those age 65 and over.

Ontario Tax Credits - This program provides refundable tax credits to low and moderate income people under age 65 to reduce their property and sales tax burden.

Ontario Home Ownership Savings Plan Tax Credit - This program provides refundable tax credits of up to $500 for individuals and $1,000 for families saving for the purchase of a first home.

Ontario Tax Reduction - This program eliminates or reduces Ontario Income Tax of up to $150 for low-income taxfilers.

Ontario Political Contribution Tax Credit - A tax credit of up to $750 is available to offset a portion of contributions made to registered provincial political parties.

Corporate Tax Expenditures 1988 Tax Rules

Corporate Income Tax

Small Business Deduction - Canadian-controlled private corporations that qualify for the federal small business deduction are eligible for a reduction of the Ontario corporate income tax rate to 10 per cent on the first $200,000 of eligible income.

Capital Cost Allowance vs Accounting Depreciation - The capital cost allowance system allows companies to expense capital assets for tax purposes at a rate that generally exceeds book or accounting depreciation.

Capital Gains Exclusion - One-third of most capital gains are taxable, and one-third of capital losses can be used to offset taxable capital gains.

Reduced Rate for Specified Sectors - A one per cent tax rate reduction is provided for income earned from manufacturing, processing, mining, logging, farming, and fishing.

Research and Development Super Allowance - This provides a deduction from income otherwise subject to tax equal to a percentage of current and capital expenditures on research and development incurred in Ontario.

Exploration and Development Expenses - All Canadian and Ontario exploration and development expenses associated with mining activities are fully deductible.

Manufacturing Current Cost Adjustment - This provides a direct deduction from income otherwise subject to tax equal to a percentage of the purchase price of new manufacturing and processing machinery purchased for use in Ontario.

Allowable Business Investment Losses - Capital losses arising from the sale of shares of Canadian-controlled private corporations may be used to reduce corporate income from any source.

Small Business Development Corporations Program - This program entitles investors to receive an Ontario Government grant (for individuals) or a tax credit (for corporations) based on the amount invested in eligible small businesses through an approved Small Business Development Corporation.

Ontario Mineral Exploration Program - Junior exploration companies, i.e. non-producing, may receive a tax credit or grant equal to 25 per cent of eligible exploration expenses.

Resource Allowance - This provides a tax deduction equal to a percentage of resource profits earned from the production of oil and gas.

Capital Tax

Flat Capital Tax for Small Business - Certain small corporations are either exempt from payment of capital tax or subject to reduced flat rate of tax.

Farm Equipment Dealers: Capital Tax Reduction - This provides for a special reduced capital tax for farm equipment dealers for the first two taxation years commencing after December 31, 1986 and before January 1, 1989.

Mining Profits Tax

Three-Year Mining Profits Tax Exemption for New Mines - Income earned from a new mine or a major expansion of an existing mine is exempt from mining tax for the first three years of commercial production.

$500,000 Mining Profits Exemption - An exemption is provided annually on the first $500,000 of mining income.

Retail Sales Tax Expenditures
1988 Tax Rules

Services

Professional - Professional fees are exempt.

Commercial - Most commercial services are exempt.

Personal - Most personal services are exempt.

Transient Accommodation - Transient accommodation is taxed at a reduced rate of 5 per cent.

Admission Fees - All admission fees to places of amusement costing $4.00 or less and other specific events are exempt.

Goods

Energy - All forms of energy, including motive fuels, are exempt.

Basic Groceries - All grocery store food, except soft drinks, snack foods and confections, are exempt from RST.

Production Machinery - Production machinery and equipment and subsequent repairs are exempt from RST.

Reading Materials - Books, newspapers and magazines purchased by subscription are exempt.

Prepared Foods - Prepared food priced at $4 or less is exempt.

Soil and Water - Soil, clay, sand, gravel, unfinished stone and natural water are exempt.

Prescription Drugs - All drugs prescribed by a doctor, dentist or veterinarian are exempt.

Children's Clothing - Children's sized clothing is exempt.

Aircraft - Commercial aircraft and parts, equipment and repairs for such aircraft are exempt.

Footwear - Footwear priced at $30 or less is exempt.

Medical Equipment - Hearing aids and dental and prescription optical appliances are exempt.

Feminine Hygiene Products - Tampons, sanitary pads and sanitary belts are exempt.

Purchaser Specific

Farmers - Most implements, machinery and repairs, and agricultural products are exempt when purchased by a person engaged in farming.

Visitors to Ontario - Out-of-province visitors to Ontario are eligible for a refund of RST paid on certain items.

Hospitals - Medical and surgical equipment purchased by a hospital is exempt.

Religious/Charitable - Used clothing and/or footwear sold by these organizations for less than $50 and meals sold at a nominal charge are exempt. These organizations' purchases of publications, items used for worship, and construction materials are exempt under certain conditions.

Disabled Persons - Most prosthetic and orthopedic devices are exempt. A rebate for RST paid on purchases of vehicles used to transport persons with physical disabilities is available.

Fishermen - Certain fishing equipment, including vessels, is exempt when purchased by commercial fishermen.

Fur-Trappers - Trapping equipment purchased by a licensed trapper is exempt.

Museums/Galleries - Works of art purchased by a museum or art gallery are exempt if more than 50% of the establishment's revenue is provided by public donations or grants.

Municipalities (fire trucks) - Fire-fighting vehicles priced at more than $1,000 and purchased for exclusive use of a municipality, public hospital, university, local service board or volunteer group are exempt.

APPENDIX II

Health Care Expenditure Profile

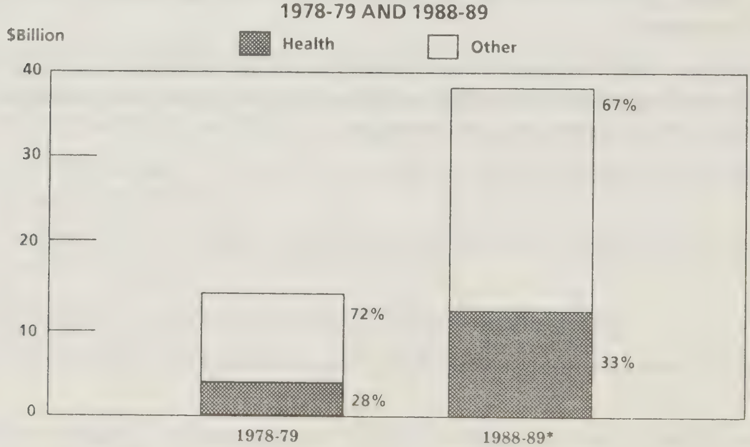
The quality, direction, and in particular the cost of health care services have been the subject of extensive public debate in recent years. This appendix, an update of the paper which originally appeared in the 1988 Ontario Budget, provides an overview of health care expenditures in Ontario between 1978-79 and 1988-89. The major components of the Ministry of Health's expenditures -- the Operation of Hospitals, the Ontario Health Insurance Plan (OHIP), and the Ontario Drug Benefit Plan (ODB) -- are examined.

In this profile, health care expenditures are defined as total expenditure outflows by the Ministry of Health. In addition, the Ministry of Community and Social Services provides health-related programs for the developmentally handicapped and for senior citizens, and the Ministry of Labour is responsible for Occupational Health and Safety legislation. The total cost of these additional health-related programs was approximately $1 billion in 1987-88.

Health Care Spending

Provincial expenditures on health care grew steadily between 1978-79 and 1988-89, consuming an increasing share of total Government resources. During this period, the share of total expenditure outflows attributable to the Ministry of Health rose from 28 per cent to 33 per cent.

MINISTRY OF HEALTH SHARE OF ONTARIO EXPENDITURES
1978-79 AND 1988-89

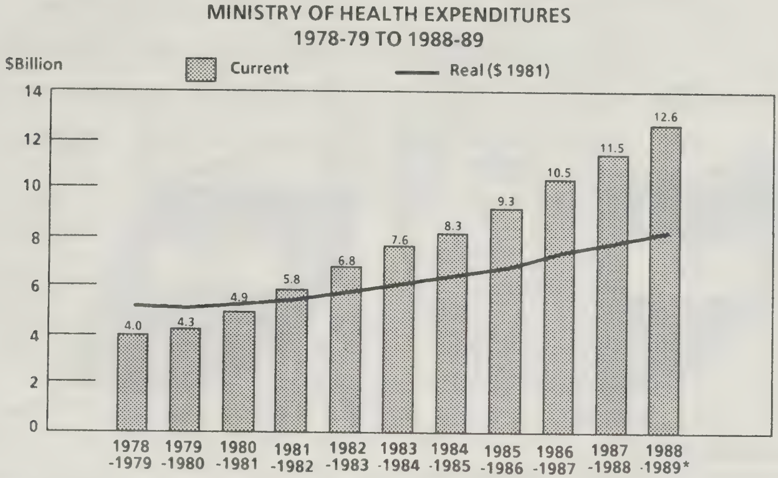


* As of September 30, 1988.

Source: Ontario Ministry of Treasury and Economics.

Health care expenditures have more than tripled in a decade, from $4.0 billion in 1978-79 to an estimated $12.6 billion in 1988-89, an average rate of growth of 12.3 per cent a year. Only about 1.1 per cent of this growth is attributed to population increases. Most of the increase in spending is therefore explained by an average

annual increase in per person spending of 11.0 per cent. Total per person health costs in 1988-89 reached $1,338.



* As of September 30, 1988.

Sources: Ontario Ministry of Treasury and Economics and Statistics Canada.

Over most of this period, growth in the health sector outpaced the growth in the Ontario economy. After taking inflation into account, expenditures on health care increased by 63.4 per cent, while Ontario's economy, as measured by real Gross Domestic Product (GDP), grew by 42.7 per cent.

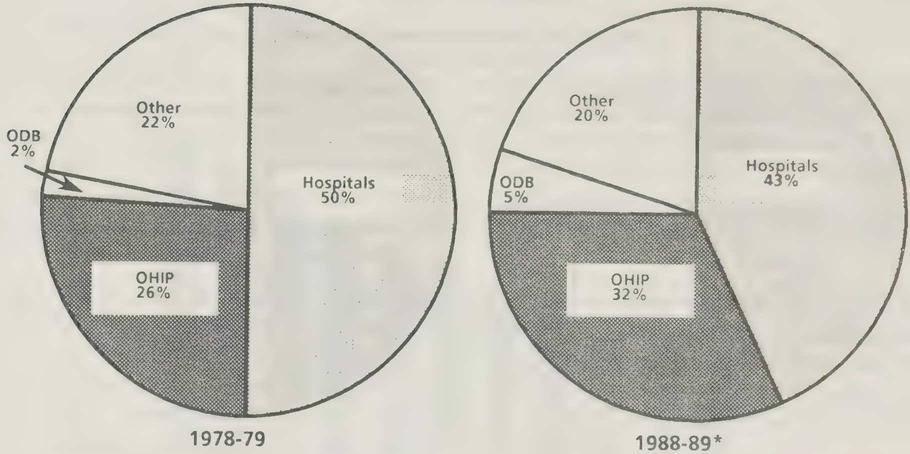
Key Components of Health Spending

Between 1978-79 and 1988-89, three areas of health services -- the Operation of Hospitals, the Ontario Health Insurance Plan (OHIP), and the Ontario Drug Benefit Plan (ODB) -- represented 78 to 80 per cent of Ministry of Health spending. The remaining expenditures were for such programs as Extended Care, Home Care Assistance, Emergency Health, Mental Health, other health care programs, and for capital requirements.

Changes in the composition of Ministry of Health spending between 1978-79 and 1988-89 are shown in the following chart. As shown, the increase in OHIP's share of health spending, from 26 per cent to 32 per cent, has compressed other areas' shares, most notably the Operation of Hospitals, which declined from 50 per cent to 43 per cent.

COMPONENTS OF HEALTH CARE SPENDING

1978-79 and 1988-89



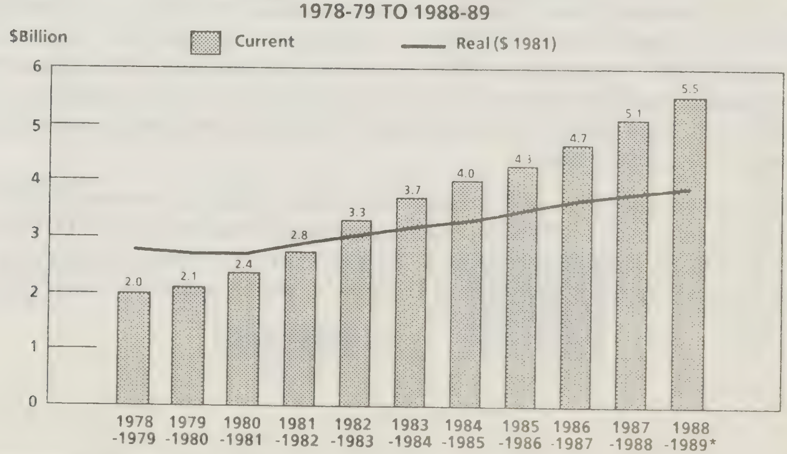
* As of September 30, 1988.
Source: Ontario Ministry of Treasury and Economics.

Operation of Hospitals

Over the past decade, Provincial expenditures on the Operation of Hospitals increased more than two and one-half times, from \$2.0 billion in 1978-79 to \$5.5 billion by 1988-89, an average annual increase of 10.7 per cent. On a per capita basis, expenditures for the Operation of Hospitals increased during this period from \$234 to \$581, an average growth rate of 9.5 per cent a year.

HOSPITAL OPERATING EXPENDITURES

1978-79 TO 1988-89



* As of September 30, 1988.
Sources: Ontario Ministry of Treasury and Economics and Statistics Canada.

Over this period, Provincial funding was provided to recognize factors such as:

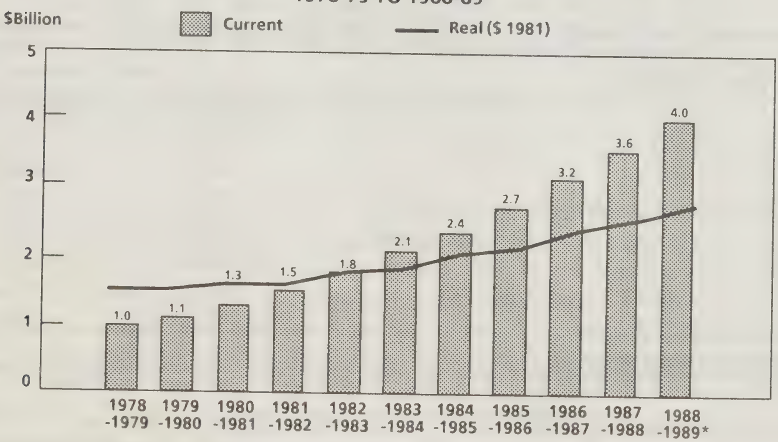
- wage and salary increases;
- more demand for hospital services;
- increased costs of high technology life-support programs; and
- the introduction of new programs and expansion of existing programs.

These hospital expenditures represent funds used solely for operating costs in Ontario's public hospitals and do not include funds for renovation costs or new construction. Over the last five years, more than $1 billion has been spent for hospital capital expenditures.

Ontario Health Insurance Plan

Expenditures for OHIP payments to physicians and other practitioners have quadrupled in the past ten years, from $1.0 billion in 1978-79 to $4.0 billion by 1988-89. Annual percentage increases in OHIP expenditures have fluctuated in a range from 9.7 per cent recorded in 1979-80, to a high of 19.7 per cent in 1982-83, averaging 14.7 per cent over the period as a whole. On a per capita basis, OHIP expenditures rose from $121 to $426, an average annual rate of 13.4 per cent over the period.

OHIP EXPENDITURES
1978-79 TO 1988-89



* As of September 30, 1988.

Sources: Ontario Ministry of Treasury and Economics and Statistics Canada.

More recently, for the period from 1981-82 to 1987-88, OHIP expenditures grew from $1.5 billion to $3.6 billion, representing an average annual rate of increase of 15.3 per cent. This consisted of an average negotiated fee increase for laboratory services, physicians and other practitioners of approximately 8 per cent a year and an average utilization increase of 7 per cent a year. Over this period, the trend in negotiated fee increases declined while OHIP utilization rates rose.

Table 1 below shows the growth in the number of Ontario licensed physicians billing OHIP and the average payment per physician from 1981-82 to 1987-88.

Ontario Licensed Physicians Billing OHIP 1981-82 to 1987-88 — **Table 1**

	Number of Physicians	Per Cent Change	Average OHIP Payments Per Physician ($)	Per Cent Change
1981-82	13,478	2.6	94,500	16.8
1982-83	13,888	3.0	109,000	15.3
1983-84	14,429	3.9	121,100	11.1
1984-85	15,039	4.2	130,500	7.8
1985-86	15,698	4.4	140,700	7.8
1986-87	16,443	4.7	154,100	9.5
1987-88	17,156	4.3	170,800	10.8

Source: Ontario Ministry of Health.

Another component of OHIP expenditures that has increased significantly in recent years is laboratory services. On average, OHIP payments for laboratory services have increased by 16.1 per cent annually over the period from 1981-82 to 1987-88.

Growth in Laboratory Services 1981-82 to 1987-88 — **Table 2**

	($ Million)	Per Cent Change
1981-82	133.9	13.1
1982-83	161.6	20.7
1983-84	184.3	14.0
1984-85	213.5	15.8
1985-86	247.5	15.9
1986-87	282.7	14.2
1987-88 (Preliminary)	327.2	15.7

Source: Ontario Ministry of Health.

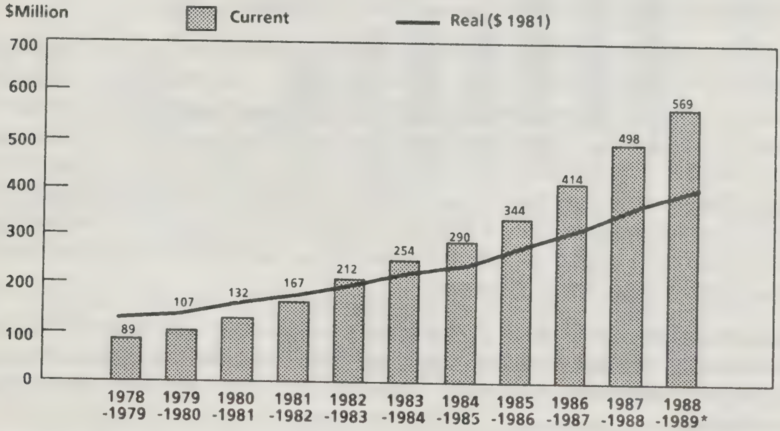
Overall, the number of OHIP claims has increased from 61 million in 1978-79 to an estimated 99 million in 1988-89. The average number of claims per capita rose from 7.2 to 10.5 over this period.

Ontario Drug Benefit Plan

The Ontario Drug Benefit Plan (ODB) was established in 1974 to ensure that the cost of prescribed drugs would not be a deterrent to the elderly and to those in need. The program ensures that seniors, social assistance recipients, and residents of extended care facilities and homes for special care receive their prescribed drugs free of charge.

Ministry of Health expenditures on the ODB plan increased from $89 million in 1978-79 to $569 million by 1988-89, an increase of 539 per cent over the period, or an average annual increase of 20.4 per cent. Much of the rate of increase in the earlier years was due to the natural growth within the eligible population. Yet double-digit rates of growth have been sustained throughout the period, making ODB one of the fastest growing health care programs over the period. Average ODB expenditures by the Ministry of Health per claimant have increased from $128 in 1978-79 to an estimated $550 in 1988-89.

ODB EXPENDITURES
1978-79 TO 1988-89



* As of September 30, 1988.

Sources: Ontario Ministry of Treasury and Economics and Statistics Canada.

Conclusion

Maintaining and improving the health care system requires substantial levels of expenditure. Factors such as the aging structure of Ontario's population have, and are expected to place even greater upward pressure on health care spending. Increases in federal transfer payments under Established Programs Financing (EPF) have not kept pace with the rapid growth in health expenditures. The search for productivity improvements and lower cost alternatives to health care that do not sacrifice the quality of care or reduce accessibility to necessary services must continue. This task requires the cooperative effort of all participants in the health care sector.

APPENDIX III

Fiscal Capacity and Tax Effort

Fiscal capacity measures the relative ability of a province to raise revenues from available revenue sources. Tax effort measures the relative extent to which each province taxes those available revenue sources. In this section, these measures are used to make interprovincial comparisons.

Determination of Fiscal Capacity

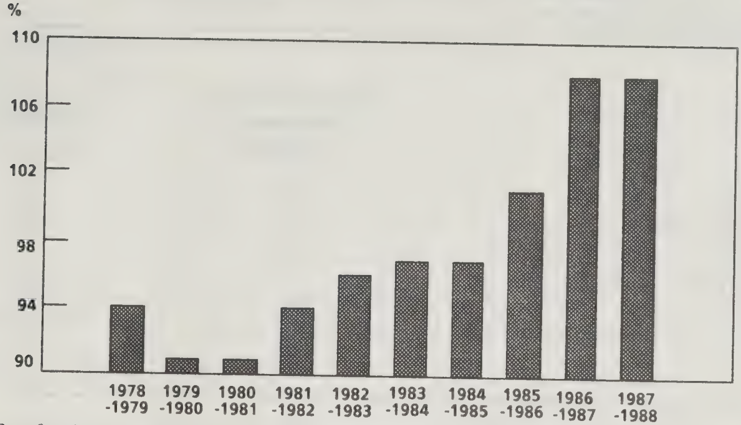
Fiscal capacity can be measured by a number of different indices.

The Representative Tax System (RTS) is the one used by the federal and provincial governments as a measurement of fiscal capacity. In the Representative Tax System, each revenue source has an associated tax base and the fiscal capacity can be related to population. For example, the base for tobacco taxes is the number of cigarettes sold in a province. If a province's share of a base is lower than its population share, that province is said to have a fiscal capacity deficiency in that tax base. If the opposite is true, a fiscal capacity surplus exists. In other words, a province has a fiscal capacity deficiency in a tax base if its per capita share of a base is less than the national average.

Tax bases are defined according to the taxing practices of provinces. For example, if an item such as infants' clothing is exempt from the retail sales tax in a majority of the provinces, such sales would not be included in the tax base. Hence, the term "representative".

Employing data from the federal equalization program, it is possible to derive an aggregate tax base share by "adding" together 37 different provincial and local tax bases. This provides a single but comprehensive measure of a province's relative fiscal capacity. In 1987-88, Ontario's fiscal capacity, measured on this basis for provincial-local own-source revenues, was 108 per cent of the national average. The chart below indicates how Ontario's fiscal capacity has varied over the past ten years.

FISCAL CAPACITY OF ONTARIO
(PER CENT OF NATIONAL AVERAGE FISCAL CAPACITY)



Notes: Data for 1986-87 and 1987-88 are subject to revision.
Index for 1987-88 is based on the phased-in value of the tax base change in the 1987 Fiscal Arrangments Regulations.

Source: Department of Finance, Canada.

As Table 1 shows, own source fiscal capacities in 1987-88 ranged from 61 per cent for Newfoundland to 144 per cent for Alberta. If federal transfer revenues are added to provincial-local own-source revenues, the fiscal capacity of "equalization-recipient" provinces approaches the national average. Since federal transfers are relatively large for the "equalization-recipient" provinces, the relative fiscal capacities of the "non-recipient" provinces decline. For example, Ontario's 1987-88 fiscal capacity declines 9 percentage points to 99 per cent of the national average, primarily because the Province does not receive federal equalization payments.

Indices of Provincial-Local Fiscal Capacity, 1987-88 **Table 1**
(Per Cent of National Average)

	Provincial-Local Own-Source Revenues	Provincial-Local Own-Source Revenues plus All Federal Transfers*
Newfoundland	61	96
Prince Edward Island	65	96
Nova Scotia	76	94
New Brunswick	71	96
Quebec	85	95
Ontario	**108**	**99**
Manitoba	83	93
Saskatchewan	91	95
Alberta	144	129
British Columbia	103	98
National Average	100	100

* Federal Transfers include federal 1987-88 Main Estimates only.
Note: Data are subject to revision.
Source: Department of Finance, Canada

Included in the determination of federal transfers are special contracting-out tax points that Quebec opted for in lieu of a portion of federal cash contributions under the Canada Assistance Plan and Hospital Insurance. The latter contributions were subsequently rolled into Established Programs Financing.

Determination of Tax Effort

A comparison of provincial tax rates on individual revenue sources (e.g. sales tax rate) is often employed as a gauge of relative revenue-raising efforts. However, such comparisons alone do not provide a way of assessing a province's overall tax effort.

As with the determination of fiscal capacity, tax effort can be measured by individual revenue sources. For each revenue source, a national average tax rate can be calculated by dividing the provincial revenues collected by the total all-province tax base. A comprehensive measure of tax effort can then be calculated by dividing a province's share of total provincial-local revenues by its share of total tax base.

This measure of tax effort indicates to what extent a province is taxing what is available to be taxed, relative to the national average. Local revenues are included because of the varying responsibilities that individual provinces allocate to their local governments. Table 2 provides the indices of relative tax effort for 1987-88 on this comprehensive basis.

Indices of Provincial-Local Tax Effort, 1987-88 — Table 2

(Per Cent of National Average Tax Effort)

Newfoundland	102
Prince Edward Island	94
Nova Scotia	92
New Brunswick	96
Quebec	120
Ontario	**98**
Manitoba	110
Saskatchewan	102
Alberta	76
British Columbia	96
National Average	100

Note: Data are subject to revision.
Source: Department of Finance, Canada

Ontario's overall tax effort is slightly less than the national average. Alberta's tax effort is about 24 per cent below the national average, mainly because it levies no sales tax and has the lowest personal income tax rates. Since Alberta's share of oil and gas revenues is about the same as its share of oil and gas tax bases, its resource taxation does not bias its tax effort one way or another.

Quebec has a very high tax effort, some 20 percentage points above the national average in 1987-88. Despite high rates of taxation on certain revenue sources, the Maritime provinces do not have a high degree of overall tax effort, due in large part to their relatively low levels of local property taxation.

APPENDIX IV

Glossary of Terms

Ad Valorem Tax - A percentage-based tax, typically applied to a measure of value such as selling price.

Basic Federal Tax - The level of tax determined by applying the federal tax rate schedule to taxable income and subtracting non-refundable credits. It is not federal tax payable, which is basic tax adjusted by credits, surtaxes or reductions. Ontario's tax rate of 51 per cent is applied to Basic Federal Tax to yield Basic Ontario Income Tax.

Canada Assistance Plan - Federal-provincial cost-sharing mechanism for provincially-administered social assistance and welfare programs.

Capacity Utilization Rate - The ratio of actual output of an industry (plant, firm, or economy) to the output it could produce with its existing plant and equipment.

Consolidated Public Sector Funded Debt - Funded debt incurred at all levels of Provincial jurisdiction, including the Province, Ontario Hydro, municipalities, hospitals, universities and colleges.

Consumer Price Index - A monthly index measuring the retail prices of a fixed basket of goods and services purchased by consumers.

Consumption - The value of spending by consumers on goods and services, measured in current dollar terms (nominal) or adjusted for inflation (real). In Ontario, consumption accounts for approximately 55 per cent of Gross Domestic Product.

Cost-of-living Adjustment - An adjustment to incomes, wages or other payments to maintain previous purchasing power in the face of changing consumer prices.

Debt to Equity Ratio - The total debt of a corporation divided by its shareholders' total equity.

Deductions - Reductions in the income tax base, usually for specific expenses incurred in order to earn income.

Deficit - The amount by which expenditures exceed revenues.

Economies of Scale - Reductions in the average cost of production achieved by increasing the volume of output.

Equalization - Unconditional transfers from the federal government to qualifying provinces with the purpose of ensuring that provincial governments have sufficient revenues to provide reasonably comparable levels of public service at reasonably comparable levels of taxation.

Established Programs Financing - Unconditional federal payments to the provinces in respect of health care and post-secondary education.

Exemptions - Amounts deductible from income in recognition of specific personal circumstances or, in the case of sales taxes, items specifically excluded from the tax base.

Expenditures - Direct expenditures on government programs include payments for goods and services, interest on the public debt, salaries and employee benefits, transfer payments to individuals, municipalities and institutions, subsidies and grants, and the acquisition and construction of fixed assets.

Export - A good or service produced in one country or jurisdiction and sold to another.

Final Demand - Domestic and foreign purchases of goods and services produced for final use within the economy, excluding inventory change.

Final Domestic Demand - Purchases of goods and services for final use within the economy, excluding the foreign sector (exports and imports) and inventory change.

Fiscal Arrangements - Institutional vehicles through which the federal government transfers funds to the provinces as part of its commitment to shared-cost programs and interprovincial fiscal capacity equalization.

Fiscal Capacity - Measure of a province's ability to raise revenues from available revenue sources relative to other provinces.

Fiscal Policy - The use of the Government's spending and taxing power to affect the aggregate level of economic activity. Expansionary fiscal policy is generally characterized by an increase in discretionary spending or a tax cut.

Fiscal Stabilization - Unconditional cash transfers from the federal government to ensure that no province's tax revenues, measured on the basis of constant tax rates and structure, plus its equalization payments, will be less than they were in the previous year.

Funded Debt - Debt which has a specified term to maturity and is secured by a debt instrument such as a bond.

Gross Borrowing - Total borrowing including borrowing necessary for debt retirement purposes.

Gross Domestic Product (GDP) - The value of goods and services produced within the geographic boundaries of an area, expressed either in current dollar value (nominal) or adjusted for inflation (real).

Gross National Product (GNP) - The value of a nation's total output of goods and services, expressed either in current dollar terms (nominal) or adjusted for inflation (real). The percentage change in real GNP is the usual measure of the real growth rate of the U.S. economy.

Group of Seven Countries - Canada, France, Italy, Japan, United Kingdom, United States and West Germany.

Guaranteed Debt - Debt for which the Province agrees to meet the costs if the borrowing party can not; primarily for Ontario Hydro.

Household Formation - Net increases in new households in a period.

Import - A good or service which has been bought from another country or jurisdiction.

Inflation - A continuing rise in the general price level.

Interest Rate - The price paid (charged) by a borrower (lender) of money. Nominal interest rates are those actually paid; real interest rates are nominal rates less the expected rate of inflation (current rates of inflation are generally used as proxies for expected rates).

Interest Service Ratio - Total interest payments taken as a per cent of cash flow of industrial corporations before interest and taxes are deducted.

Inventory - The total value of the various raw materials, goods in process, parts and finished goods held by a firm.

Inventory Accumulation - An increase in the level of inventories held in the economy.

Investment - The value of spending on capital goods such as houses, plant and machinery and equipment; may be measured in current dollar terms (nominal) or adjusted for inflation (real).

Labour Force - The total number of persons, age 15 and over, who are either employed or looking for work.

Marginal Tax Rates - A schedule of rates used to determine the amount of tax payable at various taxable income levels and on each additional dollar of taxable income.

Monetary Policy - The policies of the central bank (Canada - Bank of Canada; U.S. - Federal Reserve Board) that determine the availability and cost of credit (i.e., interest rates) in the economy. Tight (anti-inflationary) monetary policy restricts growth of the money supply, thus raising interest rates and reducing inflation by squeezing demand from the economy.

Multi-Stage Sales Tax - A percentage-based tax which applies to the difference between the taxable sales and taxable purchased inputs for each transaction of the production and distribution process, such that only the value added at each stage is taxed.

Net Borrowing - Gross borrowing less borrowing needed for debt retirements.

Net Cash Requirements (NCR) - The sum of the Deficit and the net balance of Other Transactions.

Net Migration - The difference between the total population coming into the province and the total population leaving.

Nominal (GDP, consumption, investment, etc.) - Value in current dollars (i.e., not adjusted for inflation).

Non-Marketable Securities - Securities which may not be bought or sold in public capital markets.

Non-Public Borrowing - Borrowing from non-public sources of funds, usually pension funds like the Canada Pension Plan.

Operating Position - The difference between total current revenues and total current expenditures, excluding capital expenditures.

Organization for Economic Cooperation and Development (OECD) - An organization of industrial nations, with a permanent staff of officials, established in 1961 to improve trade and investment flows among its members, to help analyze and deal with balance-of-payments and other economic problems and to coordinate foreign-aid policies.

Other Revenue - Equals total revenue minus taxation revenue and payments from the federal government. Major sources include OHIP premiums, LCBO and lottery profits, fees and licences and interest income.

Other Transactions - The lending, investment and special account administration activities of the Government, including loans, advances and investments, pensions and related benefit funds and special purpose accounts. The transactions affect only assets and liabilities accounts.

Own-Purpose Debt - Debt issued by Ontario for Provincial use only. This excludes debt issued by Ontario on behalf of Ontario Hydro.

Paid-Up Capital - For most corporations, paid-up capital funds invested in the corporation by its shareholders and other parties, loans or advances made to the corporation, and its cumulative undistributed corporate profit less its investment in other firms.

Participation Rate - The percentage of the population age 15 and over that is in the labour force.

Payroll Tax - An employment income-based tax, usually a percentage rate, which may be levied on the employer, employee or on both.

Per Capita - Per person.

Per Point Yields - An estimate of direct revenue which would be gained or lost for a first unit change in tax rates.

Personal Disposable Income - The income remaining to persons for consumption or saving after deduction of income taxes and other legislated deductions, such as CPP premiums.

Personal Income - The income received by persons from all sources.

Personal Income Tax Revenue Guarantee - Federal program to ensure that amendments to the federal Income Tax Act will not reduce a province's personal income tax revenues by more than one per cent, by providing compensation.

Personal Savings Rate - Percentage of personal disposable income that is not spent on current consumption.

Prime Rate - The interest rate charged by chartered banks to their most credit-worthy customers.

Productivity - Output per unit of input (labour, capital, energy) employed.

Protectionism - Advocacy of protective tariffs and other barriers to trade as a means of developing national wealth.

Public Borrowing - Borrowing which is done through public capital markets.

Public Debt Interest - Interest paid by Ontario on total debt incurred for its own purpose.

Real (GDP, consumption, etc.) - Adjusted for inflation, constant dollar.

Recession - A downturn in the business cycle, characterized by weak economic activity and high unemployment. Two consecutive quarters of decline are generally considered to indicate a recession.

Recovery - The upturn of the business cycle following a recession, characterized by an increase in economic activity.

Representative Tax System - A series of thirty-seven distinct revenue sources used to determine what provinces, collectively, tax.

Revenue - Includes revenue raised through taxation, premiums, fees, licences and permits, payments from the federal government under the Fiscal Arrangements and shared-cost programs and income from investments.

Seasonal Adjustment (seasonally-adjusted) - A statistical adjustment to take account of seasonal factors, such as weather, so that data more accurately reflect underlying trends.

Specific Rate of Tax - A fixed rate per unit (e.g., gasoline is taxed at a rate of 9.3 cents per litre).

Surtax - A tax additional to basic Ontario or basic federal tax, usually calculated with reference to basic tax or to taxable income.

Tariff - A tax imposed on imported goods, levied either as a percentage of their value or according to the number of units imported.

Tax Base - The taxable value to which tax rates are applied (e.g., the taxable portion of income; or the value of goods and services taxed under the retail sales tax).

Tax Collection Agreement - The agreement between each province and the federal government that authorizes the federal government to collect that province's personal income tax. Under the current arrangements, the provinces agree to calculate their tax as a percentage of basic federal tax, effectively waiving all rights to determine the tax base. Provinces are permitted limited credit and surtax/reduction programs. Some provinces have similar arrangements for corporate income taxes.

Tax Credit - A reduction of certain taxes paid, with the amount of the credit determined by a specified formula. The Ontario Tax Credits, for example, offset property and sales taxes for individuals by reducing Ontario personal income taxes. The level of this credit is a function of both the amount of tax paid and the ability to pay of the individual. As a result, credit benefits fall as income rises, effectively redistributing tax burdens in favour of lowest income individuals.

Tax Effort - Measure of the extent that a province actually taxes available revenue sources relative to other provinces.

Total Debt - Funded and unfunded debt borrowed for the Province.

Unemployment Rate - The number of persons in the labour market who are unemployed, as a percentage of the labour force; may be either seasonally-adjusted or unadjusted (actual).

Unfunded Debt - Debt which is not secured by a debt instrument, such as deposits with the Province of Ontario Savings office.

Unit Labour Cost - A measure of productivity calculated by dividing the total wage bill by the total number of units of a good or service produced.

Value-Added - The value of a firm's output minus the value of the inputs it purchases from other firms.

Review of Selected Financial and Economic Statistics
($ million)

	1978-79	1979-80	1980-81	198
Revenue	12,338	14,236	15,585	17,
Expenditure	13,924	15,357	16,882	19,
Deficit	1,586	1,121	1,297	1,
Other Transactions (net)	406	537	494	
Net Cash Requirements	1,180	584	803	1,
Financial Position				
Total Debt	16,467	18,096	19,512	21,
Funded Debt[1] (excluding Ontario Hydro)	14,038	15,196	16,215	17
Provincial Debt Transactions (net)	1,652	1,133	968	1
Gross Domestic Product (GDP) at Market Prices[2]	92,414	104,363	114,994	131
Personal Income[2]	75,832	84,607	94,411	110
Population - June ('000)	8,440	8,501	8,570	8
Funded Debt per Capita (dollars)	1,663	1,788	1,892	2
Personal Income per Capita (dollars)	8,985	9,953	11,016	12
Expenditure as a per cent of GDP	15.1	14.7	14.7	
Deficit as a per cent of GDP	1.7	1.1	1.1	
NCR as a per cent of GDP	1.3	0.6	0.7	
Total Debt as a per cent of GDP	17.8	17.3	17.0	
Funded Debt as a per cent of GDP	15.2	14.6	14.1	
Cumulative Net Borrowing for Ontario Hydro				
U.S.	4,141	4,506	4,379	5
C.P.P.	–	–	500	1
Contingent Liabilities (mainly Ontario Hydro)	7,096	7,904	8,553	9

1 Funded Debt includes debentures, notes and Treasury Bills.

2. Gross Domestic Product and Personal Income are calculated on a calendar year basis. The amounts appearing in a fiscal year column are for the preceding calendar year.

3 Ontario Finances, September 30, 1988

Note: All funds are quoted in Canadian dollars.
* Excluding extraordinary adjustments.
N/A - not available.

Source: Ontario Ministry of Treasury and Economics

1982-83	1983-84	1984-85	1985-86*	1986-87	1987-88	Interim 1988-89[3]
19,367	21,412	23,893	26,240	29,544	32,453	36,273
22,556	24,565	26,452	28,854	32,178	34,942	37,884
3,189	3,153	2,559	2,614	2,634	2,489	1,611
711	864	857	1,009	1,286	1,203	1,129
2,478	2,289	1,702	1,605	1,348	1,286	482
23,955	27,406	30,041	32,904	35,103	36,981	38,787
19,643	22,503	24,593	26,695	27,921	28,822	29,577
2,051	2,860	2,090	2,102	1,194	901	755
137,310	151,945	170,881	185,606	204,407	224,241	244,770
122,443	131,947	146,006	158,552	171,221	186,628	201,524
8,703	8,798	8,902	9,006	9,113	9,271	9,431
2,257	2,558	2,763	2,964	3,064	3,109	3,136
14,069	14,997	16,403	17,605	18,789	20,130	21,368
16.4	16.2	15.5	15.5	15.7	15.6	15.5
2.3	2.1	1.5	1.4	1.3	1.1	0.7
1.8	1.5	1.0	0.9	0.7	0.6	0.2
17.4	18.0	17.6	17.7	17.2	16.5	15.8
14.3	14.8	14.4	14.4	13.7	12.9	12.1
6,058	6,487	7,206	7,189	6,667	6,033	N/A
1,000	1,000	1,000	1,000	1,119	1,508	N/A
11,122	12,711	14,220	15,963	17,603	18,595	N/A

Economic Outlook and Fiscal Review

ONTARIO 1989

Ontario
Ministry of
Treasury and
Economics

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November 1989

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Preface

In Spring 1986, the Legislature set up the Standing Committee on Finance and Economic Affairs to "consider and report to the House its observations on the fiscal and economic policies of the Province." The 1989 Economic Outlook and Fiscal Review is part of the Government's efforts to assist the Committee in its endeavours and to enhance the process of public consultation leading to the development of the 1990 Ontario Budget.

THE ONTARIO ECONOMIC OUTLOOK

Ontario Economic Outlook at a Glance — **Table 1**

	1988	1989	1990
Real Growth (%)	5.6	2.8	2.0
Job Creation (000s)	173	90	71
Unemployment Rate (%)	5.0	5.1	5.5
Inflation (%)	4.7	5.9	5.3

In 1989 the Ontario economy began a transition to more moderate and sustainable growth, following six years of rapid expansion.

The economy is expected to continue to expand in 1990, but at a more modest pace than in recent years. Smaller employment gains and a stable savings rate will continue to restrain spending growth compared to the 1985-1988 period.

Ontario's economy is expected to generate 71,000 new jobs, following employment growth of 90,000 in 1989. The unemployment rate in 1990 is expected to rise four-tenths of a percentage point to 5.5 per cent. Ontario will continue to have the lowest unemployment rate among the provinces.

Inflation is expected to decline in 1990, reflecting the effect of more moderate growth in employment and output.

Ontario Economic Outlook: The Transition to Sustainable Growth

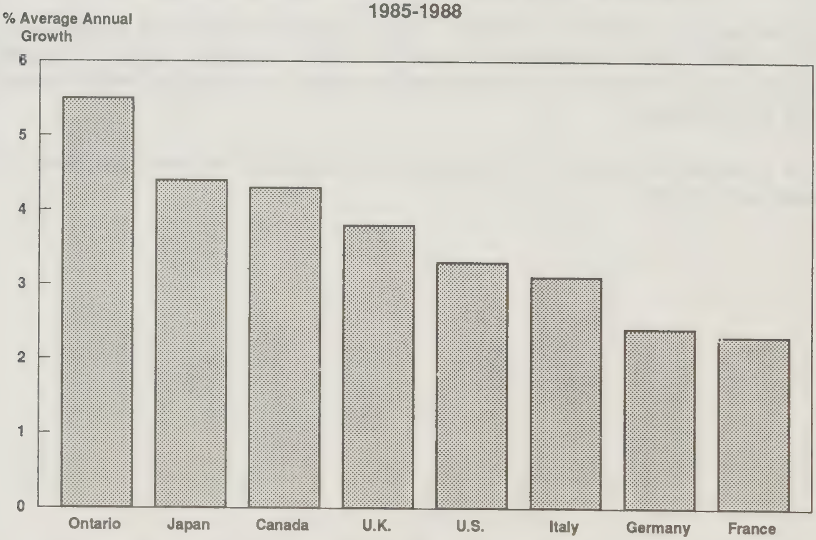
Recent Performance: Growth Continues

In 1989 the Ontario economy entered a period of more moderate growth, with output increasing by an estimated 2.8 per cent and employment by 1.9 per cent. This moderation reflects slower demand growth throughout the industrial world and the absorption of unused resources over the past several years.

Ontario emerged from the 1981-1982 recession with substantial unemployed labour, excess plant capacity, significant pent-up demand for consumer durables and housing, and a high level of savings. These factors made possible the rapid growth in output and employment through the first six years of the expansion.

Real output returned to its pre-recession peak in 1984. Between 1985 and 1988, real output in Ontario grew by an average 5.5 per cent per year, and employment increased by 3.5 per cent annually. In both output and employment, Ontario experienced higher growth than any of the major industrialized countries.

INTERNATIONAL COMPARISON OF REAL OUTPUT GROWTH
1985-1988



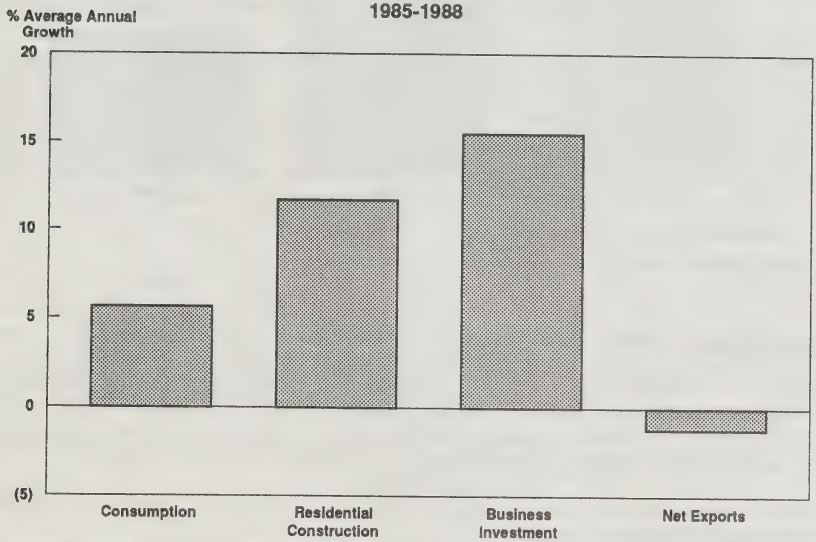
Source: I.M.F., Statistics Canada and Ontario Ministry of Treasury and Economics.

Consumer spending and exports were the fastest growing components of aggregate demand during the 1983-1984 period. By contrast, in the 1985-1988 period, the expansion was led primarily by residential construction and business investment in plant and equipment. The strength of the expansion was based on growth in personal income and corporate profits, healthy growth abroad, lower oil prices, stable interest and inflation rates, and an exchange rate that enhanced international competitiveness during the early part of the period.

Real business investment grew at an average annual rate of 15.5 per cent over the 1985-1988 period. Plants were modernized to meet international competition, and capacity increased to satisfy growing foreign and domestic demand.

Over 350,000 homes were built in Ontario in the 1985-1988 period. Strong growth in residential investment was supported by pent-up demand from the early 1980s, high levels of net interprovincial and international migration, and a decline in mortgage interest rates from the levels of the early 1980s. The high level of net migration to the province contributed to strong growth in the labour force. This, combined with reasonably stable inflation, resulted in moderate wage increases and rapidly growing employment.

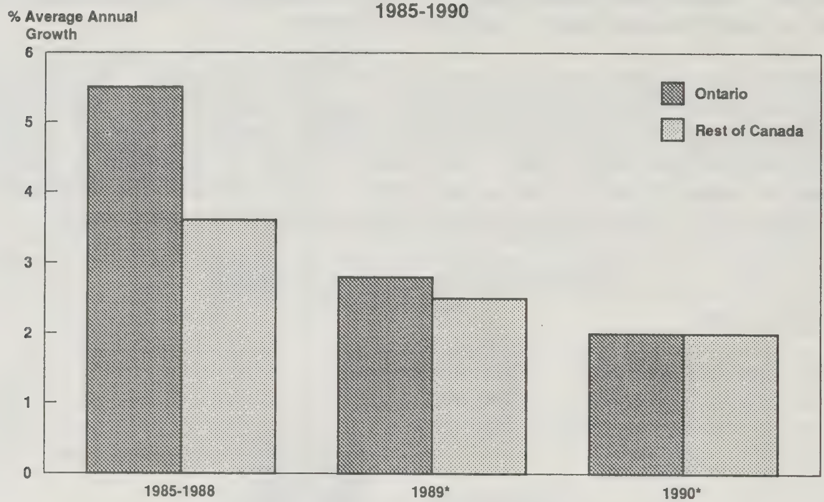
SOURCES OF REAL GROWTH IN ONTARIO
1985-1988



Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

Throughout the expansion, growth in Ontario outpaced that in the rest of Canada. During 1989, however, growth across the country has become more balanced. Real output growth in Ontario will average 2.4 per cent per year in 1989-1990, roughly in line with growth in the rest of the country.

REAL GROWTH: ONTARIO VS. REST OF CANADA
1985-1990



* Estimate for 1989 and forecast for 1990.

Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

Key Assumptions: 1990

International and interprovincial exports account for almost half of the province's GDP. The growth prospects of Ontario's major trading partners therefore have a significant impact on Ontario's short-run economic performance. Financial markets and energy prices also have an important bearing on the outlook.

Ontario's Export Markets, 1988 — **Table 2**

	Share of Ontario GDP (%)	
Total International		31.9
United States	27.5	
European Community	1.5	
Japan	0.6	
Other	2.3	
Rest of Canada		15.0
Total		46.9

Source: Ontario Ministry of Treasury and Economics.

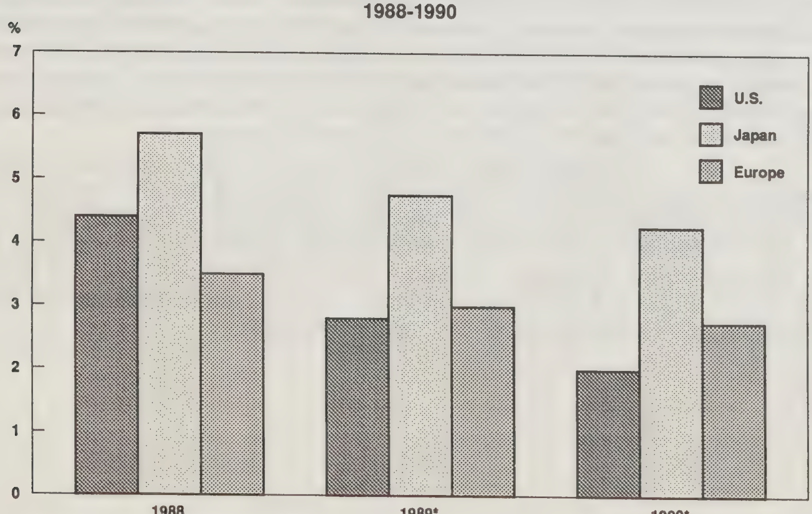
International Outlook
The rate of expansion of the United States economy is expected to decline modestly over the next year. Following an estimated gain of 2.8 per cent this year, United States real GDP is projected to expand by 2.0 per cent in 1990. While momentum will moderate from the pace exhibited since the start of 1988, the steady growth experienced so far this year and lower short-term interest rates have reduced fears of a recession in the near future.

Reduced buoyancy in net exports and business investment, which have led United States growth in recent years, will contribute to more subdued performance over the next year. Since the beginning of 1989, the United States dollar has risen by about ten to fifteen per cent against most major currencies. This rise, mirroring interest rate differentials and political uncertainties, will slow the growth of United States exports.

As a result of higher social security taxes and weaker growth in defence spending, fiscal policy in the United States will become somewhat more restrictive in 1990. Improvements in credit availability will help to offset the projected tightening of the federal government's budgetary stance. Due to the modest easing of Federal Reserve Board policy in mid-1989, short-term interest rates in the United States have declined by about one percentage point from their spring peaks. As borrowing costs have fallen, lower mortgage rates have provided support for residential construction.

Consumer price inflation in the United States rose in early 1989 to the highest level since the recession, reflecting pressures created by economic growth and higher costs for food and energy. Improved supply conditions for these products have eased inflation in recent months. The rate of increase of United States consumer prices is expected to drop to about 4.5 per cent in 1990 from about 5.0 per cent this year.

REAL GROWTH OF ONTARIO'S INTERNATIONAL TRADING PARTNERS
1988-1990



* Estimate for 1989 and forecast for 1990.

Source: OECD and Ontario Ministry of Treasury and Economics.

Economic growth in the other OECD countries will generally show more strength than in the United States in 1990. The OECD forecasts a 4.25 per cent pace of growth in Japan next year, down from 4.75 per cent in 1989. Growth in Western Europe will decelerate from 3.0 per cent this year to 2.75 per cent in 1990.

Rest of Canada

Growth in the rest of Canada in 1990 is expected to make a modest contribution to Ontario's export position, with strength in the Western provinces offsetting softness in Atlantic Canada.

Weakness in the fishing industry and reduced defence spending will slow growth in the Atlantic provinces in 1990. Offshore oil and gas development continues to be delayed. Increased coal production and the expansion of electric generating plants will have a modest positive effect.

In Quebec, which accounts for the largest proportion of Ontario's interprovincial exports, weaker consumer spending and moderation in investment are expected to lead to slower growth in 1990.

Manitoba and Saskatchewan are expected to record higher growth rates in 1990 as farm output continues to rebound following the 1988 drought. A recovery in oil and gas investment and new strength in forestry investment will contribute to stronger growth in Alberta.

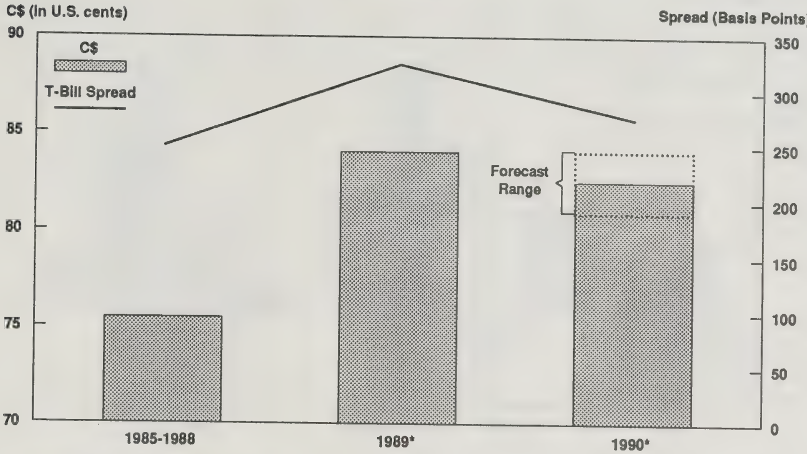
The forestry-dominated economy of British Columbia will be boosted by a recovery in the United States housing sector. Strong immigration will support rapid growth in the service sector in British Columbia this year and next.

Financial Markets

The Bank of Canada has increased the Canada-United States interest rate differential to levels unprecedented except during currency crises, triggering a further appreciation of the dollar. The short-term differential has averaged over 3.25 percentage points in 1989, sharply higher than its 1980-1988 average of 1.90 percentage points. In recent months the gap has exceeded four percentage points. Since early 1986, the Canadian dollar has risen from 69 cents U.S. to about 85 cents U.S., a 23 per cent increase.

The recent convergence of Canada-United States inflation rates and the rise in the Canadian dollar indicate that there is room for a narrowing of the Canada-United States short-term interest rate differential. The forecast assumes that the Bank of Canada will allow the interest rate differential to narrow in early 1990. The average value of the dollar is expected to fall to the U.S. 81 to 84 cent range. Interest rates in Canada are expected to fall modestly through the first half of 1990 as growth slows.

CANADA-U.S. EXCHANGE RATE AND 3-MONTH TREASURY BILL SPREAD
1985-1990



* Estimate for 1989 and forecast for 1990.

Source: Bank of Canada and Ontario Ministry of Treasury and Economics.

Energy Prices

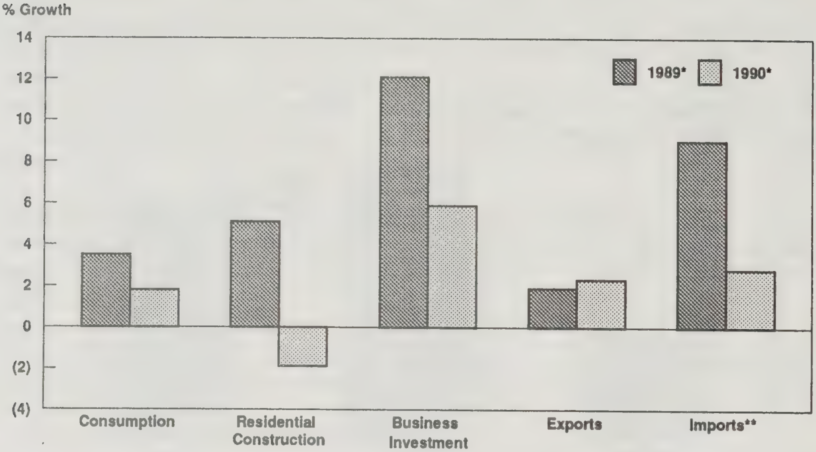
Ontario's oil and gas bill is expected to increase by eight per cent in 1989 and remain unchanged in 1990. During 1990, modest increases in the demand for refined petroleum products and natural gas are expected to be offset by small price decreases.

The direction of world oil prices in 1990 will be influenced by slower demand growth in the industrialized countries owing to a slowing global economy, a relatively stable political environment within OPEC, and the re-establishment of more normal supply arrangements in Alaska and the North Sea after this year's disruptions. These factors are expected to result in an average world oil price of $17.50 U.S. per barrel for 1990 compared to an estimated average for 1989 of $18.50 U.S.

The Outlook for 1990: More Moderate Growth and Inflation

Business investment will continue to grow more quickly than other components of demand in 1990. Growth in other sources of domestic demand, most notably consumer spending and housing, will continue to moderate.

SOURCES OF REAL GROWTH IN ONTARIO
1989 and 1990

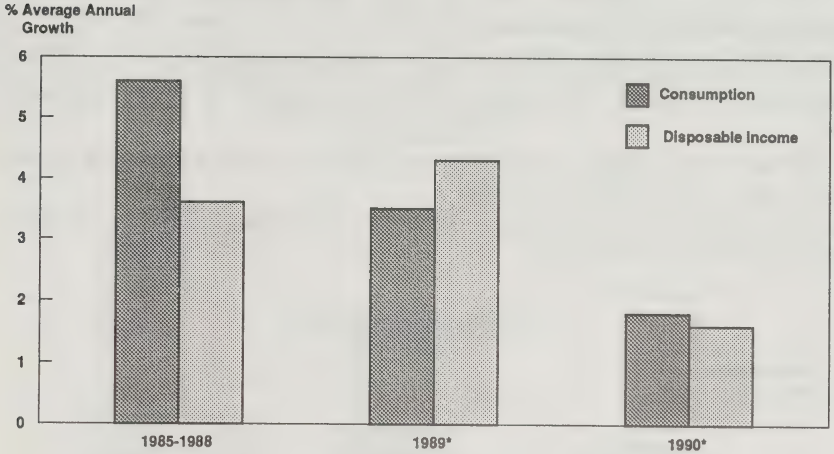


* Estimates for 1989 and forecast for 1990.
** Import growth has a negative effect on real growth.
Source: Ontario Ministry of Treasury and Economics.

Consumer Spending
Robust growth in personal income and a decline in the savings rate to a 16-year low fuelled strong growth in consumer spending over the 1985-1988 period. The moderation in growth of personal spending that has been evident in 1989 is expected to continue into 1990, reflecting a small upturn in the personal savings rate from its 1988 low, high consumer debt loads and slower income growth. Growth in real consumption will moderate from 3.5 per cent in 1989 to 1.8 per cent in 1990, down from 4.7 per cent in 1988. Over the 1985-1988 period, consumer spending growth outpaced the increase in personal disposable income, leading to a continued drop in the savings rate and an increase in debt loads. The savings rate rose from 12.2 per cent in 1988 to 12.6 per cent in 1989, reflecting consumer caution and the incentive of higher interest rates. The savings rate will edge down to 12.4 per cent in 1990.

REAL CONSUMPTION AND REAL PERSONAL DISPOSABLE INCOME

1985-1990



* Estimate for 1989 and forecast for 1990.

Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

High interest rates and the high level of household debt relative to disposable income will restrain consumers from going further into debt to finance their purchases. The burden of household debt payments has grown rapidly since 1985. Between the first quarter of 1985 and the second quarter of 1989, total consumer and mortgage debt held by Canadians increased 88 per cent while disposable income rose only 35 per cent. Rising debt loads have made consumer behaviour more sensitive to interest rate movements.

Personal income growth is expected to moderate to 7.1 per cent in 1990 from 9.0 per cent in 1989 as job creation slows. Increases in investment income and in wages will partially offset the effects of smaller job gains.

In 1989 and 1990, spending on goods will grow more slowly than on services. Demand for consumer durables such as automobiles and major appliances will be the weakest component in consumer spending. The recent strength in housing-related durables spending is expected to diminish considerably as the pace of residential construction moderates.

Housing

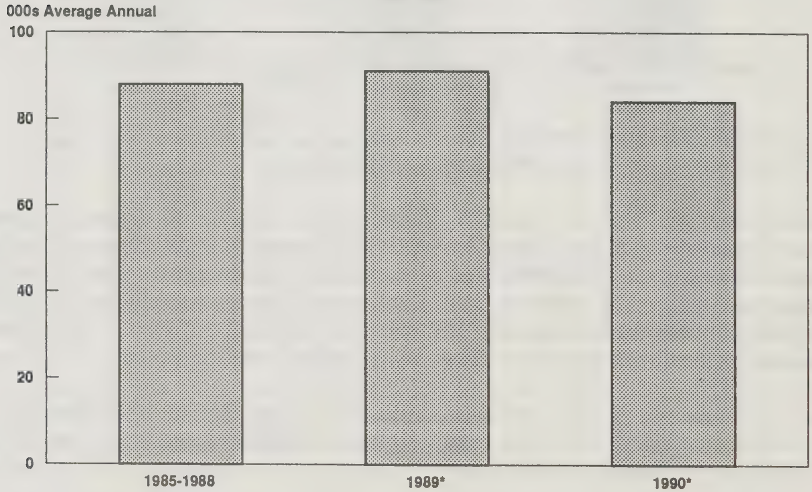
The housing market has been strong over the 1985-1988 period. Real residential investment growth averaged 11.7 per cent per year over the period. Housing starts totalled over 350,000. Several factors account for the recent strength in residential construction in Ontario:

- the favourable economic climate, with strong employment and income growth and declining interest rates in the early part of the period;
- pent-up demand from the recession; and
- the high level of net migration, especially interprovincial migration.

The current slowing in housing starts, sales and price increases reflects softening in the same underlying factors that initially fuelled strong residential construction:

- the economy is growing more slowly;
- much of the pent-up demand from the early 1980s has been met;
- affordability remains an issue due to high home prices and high short-term interest rates;
- in 1989 and 1990, housing completions are expected to outpace demand growth, adding significantly to the housing stock; and
- interprovincial migration is slowing, although international migration remains a strong source of demand for housing.

ONTARIO HOUSING STARTS
1985-1990



* Estimate for 1989 and forecast for 1990.
Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

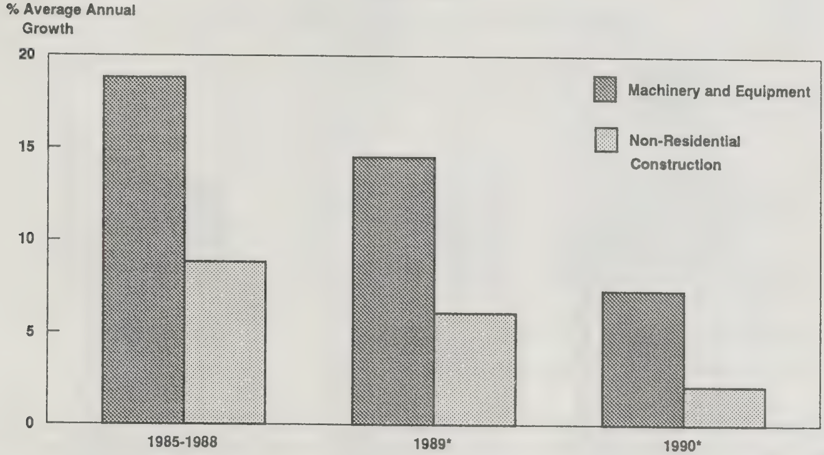
New home construction has continued at a healthy pace in 1989, reflecting strong pre-sales in late 1988 and early 1989. Housing starts are expected to total 91,000 in 1989. In 1990, a moderate pace of 84,000 starts is forecast.

Real residential investment is expected to grow by 5.1 per cent this year and to contract by 1.9 per cent in 1990. Renovation activity, which accounts for about one-third of total residential investment, is forecast to grow moderately.

Resale activity is expected to remain soft through 1989 and to pick up during the first half of 1990 as interest rates ease.

Business Investment
Investment in plant and equipment was the most rapidly growing component of demand in 1988 and has remained so again this year. Further increases are expected next year, although at a slower pace. Strength in business investment is the result of healthy corporate profits, high rates of capacity utilization, continued sales growth, declining machinery and equipment prices, and the pressure of international competition.

REAL BUSINESS INVESTMENT
1985-1990



* Estimate for 1989 and forecast for 1990.

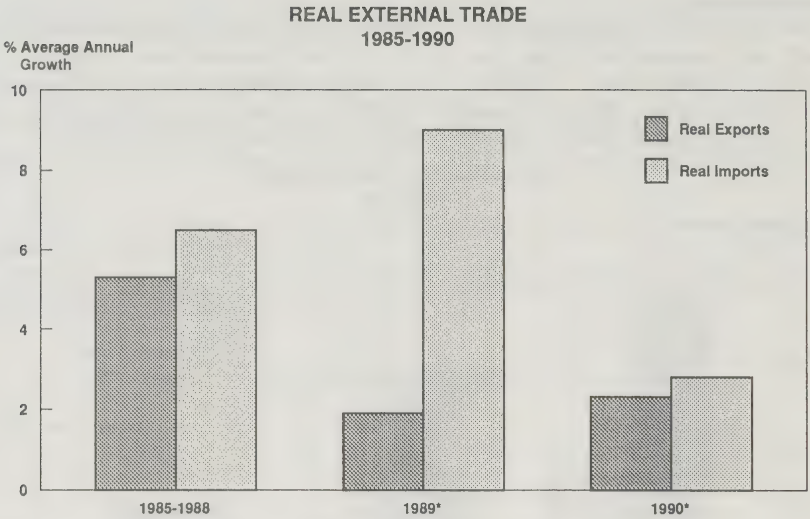
Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

Total real business investment is forecast to increase by 5.9 per cent in 1990. Real non-residential construction is expected to grow by 2.1 per cent in 1990, following an estimated 6.1 per cent rise this year. Real machinery and equipment investment is forecast to increase by 7.3 per cent in 1990, after an estimated 14.5 per cent increase in 1989.

Following an estimated 4.8 per cent increase in 1989, corporate profits are expected to grow by 6.7 per cent in 1990. The appreciation of the Canadian dollar and moderating demand are restraining profit growth to well below the 14.4 per cent annual average recorded over the 1985-1988 period.

As a result of steady increases in industrial production, capacity utilization rates rose steadily from the end of the 1981-1982 recession until 1988. Smaller increases in domestic sales, weaker exports and new capacity resulting from the investment boom have caused capacity utilization rates to decline slightly in 1989. This will tend to moderate business investment in 1990.

External Trade
Imports of goods and services have been growing considerably faster than exports in 1989. Although import growth will slow in 1990, export growth will still lag slightly.



* Estimate for 1989 and forecast for 1990.

Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

Export growth has slowed in 1989, primarily reflecting the higher Canadian dollar and slower growth in the United States. In real terms, Ontario exports are expected to grow by a modest 1.9 per cent in 1989, down from 8.0 per cent last year. In 1990, real export growth is expected to rise marginally to 2.3 per cent.

The 23 per cent appreciation of the Canadian dollar against the United States dollar since early 1986 has adversely affected the cost advantage enjoyed by Ontario's exports in the United States, where 86 per cent of Ontario's merchandise exports are sold. Within Canada, strength in Ontario's exports to Western Canada is expected to be offset by weaker growth in exports to Quebec and the Atlantic provinces.

Imports have increased significantly in 1989 in response to the continued strength in consumer spending and the surge in machinery and equipment investment, most of which is imported. The appreciation of the Canadian dollar has made foreign purchases cheaper. Real imports are expected to rise by 9.0 per cent in 1989, slowing to 2.8 per cent in 1990 as consumer spending and investment moderate.

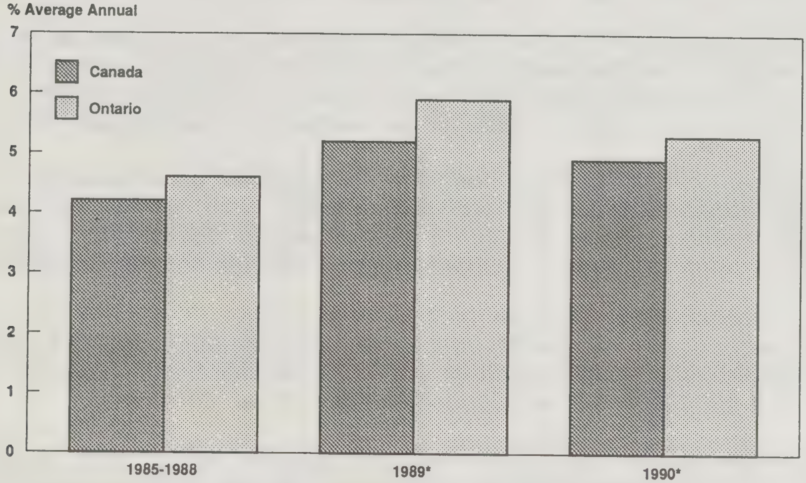
Inflation

Over the 1985 to 1988 period, Ontario's inflation rate as measured by the Consumer Price Index was relatively stable, ranging from a low of 4.1 per cent to a high of 5.1 per cent.

In 1989, inflation rose to an estimated 5.9 per cent in Ontario and to 5.2 per cent nationally. Several factors contributed to the rise, including higher wage settlements, higher oil prices and increases in indirect taxes. The appreciation of the Canadian dollar and less rapid economic growth have partially offset these factors.

Over the 1980-1986 period, the difference in inflation between Ontario and Canada averaged 0.1 percentage points, compared to 0.7 percentage points during 1987-1989. The gap between the Ontario and national inflation rates in recent years has been primarily the result of house price increases in the Toronto region. In 1990, the Ontario-Canada inflation gap is expected to narrow as house price increases in Southern Ontario moderate. Inflation in Canada and Ontario is expected to moderate in 1990 to 4.9 per cent and 5.3 per cent, respectively, in response to slower growth in demand and employment.

CANADA AND ONTARIO CPI INFLATION RATE
1985-1990



* Estimate for 1989 and forecast for 1990.

Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

The Medium-Term Outlook for 1991-1993

In August the federal government announced details of its plans to introduce a 9 per cent Goods and Services Tax (GST) to take effect January 1, 1991. The economic effect of this tax, if it proceeds, will depend on the tax base and rate that are ultimately decided upon. If the tax proceeds as announced, its imposition will have significant effects on the Ontario economy in the medium term. For the purpose of this medium-term outlook, it is assumed that the GST will proceed as announced.

The Ontario Economy: 1991-1993 (Annual Average) — **Table 3**

Real Growth (%)	3.0
Inflation (%)	6.3
Job Creation (000s)	76
Unemployment Rate (%)	5.5

Source: Ontario Ministry of Treasury and Economics.

Over the 1991-1993 period, real output growth is expected to average 3.0 per cent per year. Business investment will continue to lead growth over this period. The CPI inflation rate is expected to average 6.3 per cent per year, 1.0 per cent above the expected 1988-1990 average. Job creation is expected to average 76,000 over the 1991-1993 period, down from an average of 111,000 in 1988-1990.

Annual growth in personal income in nominal terms is expected to average 8.8 per cent over the medium term, slightly above the 8.6 per cent average recorded during the 1988-1990 period. Inflation induced by the proposed GST is expected to offset slower job creation over the period.

Real consumer spending is forecast to increase at an average annual pace of 2.1 per cent, well below the 3.4 per cent rate recorded over the previous three years. Consumption growth will be restrained by slower employment growth and continuing high interest rates, as well as by the loss in real disposable income resulting from the proposed GST.

Despite slowing population growth, changes in the age profile of the population will tend to increase housing activity over the medium term. The baby-boom workforce is increasingly entering the age group typified by home purchase and renovation. As a result, residential investment is expected to expand slightly more quickly than the economy as a whole.

Real business investment is expected to remain the fastest growing source of demand in the Ontario economy, expanding at an annual rate of 7.5 per cent. This represents a slowing from the 11.3 per cent annual pace recorded over the previous three years.

Real net exports are forecast to decline marginally over the medium term, in response to continuing strong growth in machinery and equipment imports. Nevertheless, trade will be much less of a negative influence on the economy over the 1991-1993 period than it is projected to be over the 1988-1990 period.

Effects of the Proposed GST

If the federal Goods and Services Tax proceeds, it is expected to raise the consumer price inflation rate by an average of 1.6 per cent annually over the 1991-1993 period and to cause a loss in average real growth of 0.2 per cent annually. The GST is expected to reduce employment growth by an average of 18,000 jobs per year.

Workers are expected to attempt to recoup lost purchasing power by demanding larger wage increases. The Bank of Canada is expected to raise interest rates to attempt to counter this wage response.

The main effects of the introduction of this tax will be felt in 1991, with some adverse effects persisting in subsequent years.

First-Year Effects of the Proposed GST on the Ontario Economy **Table 4**

	1991
Real GDP Growth (%)	(0.4)
CPI (%)	3.2
Job Creation (000s)	(23)
Unemployment Rate (%)	0.3

Source: Ontario Ministry of Treasury and Economics.

In 1991, the proposed GST will cause an initial direct rise in consumer prices. While this initial effect is expected to be close to the 2.25 per cent estimated by the Department of Finance, it will be followed by indirect effects that will raise inflation in Ontario by 3.2 percentage points in 1991.

Higher wage demands, if successful, will dampen the negative effect of the tax on real disposable income and thus cushion the first-year effects on output and employment. However, the inflation generated by this wage pressure will reduce growth in real income and employment in subsequent years.

Consumer spending will be particularly hard hit by the GST, as real personal income is eroded due to higher prices and lower employment growth. An expected rise in interest rates to counter GST-related inflation will further erode spending on consumer durables and housing.

The removal of the Manufacturers Sales Tax on business inputs will encourage investment by lowering the cost of capital. However, lower consumer spending will offset, at least in part, the stimulation of business investment arising from the GST.

The initial effect of the proposed GST on the international trade balance will be positive as sales taxes are removed from business inputs used in the production of exports and as imports face an increased relative tax burden. However, this effect is expected to be offset in 1992 and 1993 by added employment costs associated with higher prices and wages and by the initial appreciation of the Canadian dollar in response to higher interest rates.

Labour Force and Employment

The Outlook for 1990

In 1990, an estimated 71,000 new jobs will be created in Ontario. Employment growth will slow modestly but will remain high relative to that in the major industrialized economies. The unemployment rate will increase to 5.5 per cent, but will remain well below the national average of 8.1 per cent.

Ontario Labour Market Outlook — **Table 5**

	1988	1989	1990
Labour Force (000s)	5,118	5,216	5,312
Change (%)	2.5	1.9	1.8
Employment (000s)	4,862	4,952	5,023
Change (%)	3.7	1.9	1.4
Job Creation (000s)	173	90	71
Unemployment (000s)	256	264	289
Unemployment Rate (%)	5.0	5.1	5.5
Participation Rate (%)	69.6	69.7	69.8

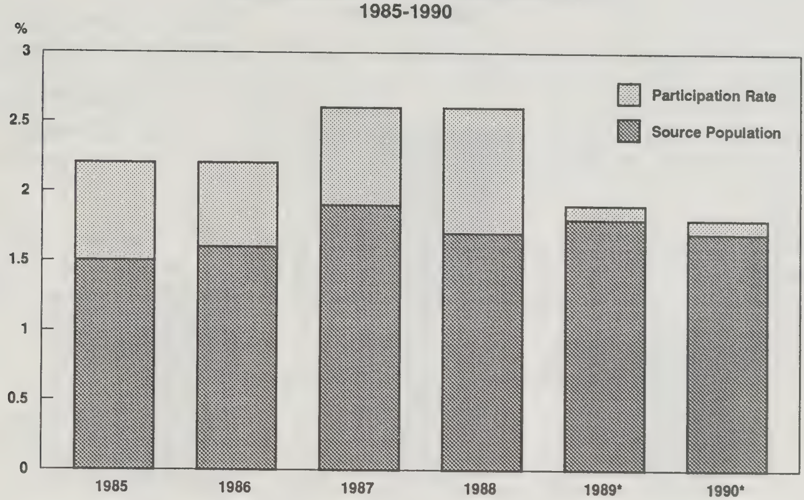
Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

The Labour Force

Ontario's labour force has grown at an annual average rate of 2.3 per cent since 1985. This growth has been fuelled by high levels of net migration and continuing increases in the female participation rate. It is estimated that 79 per cent of working-age males and 61 per cent of working-age females participated in the labour force during 1989.

Ontario's labour force is expected to increase by 1.8 per cent in 1990. Growth in the working-age population will account for 94 per cent of the change, while participation rate increases will account for the remaining six per cent.

ONTARIO LABOUR FORCE GROWTH
1985-1990



* Estimate for 1989 and forecast for 1990.

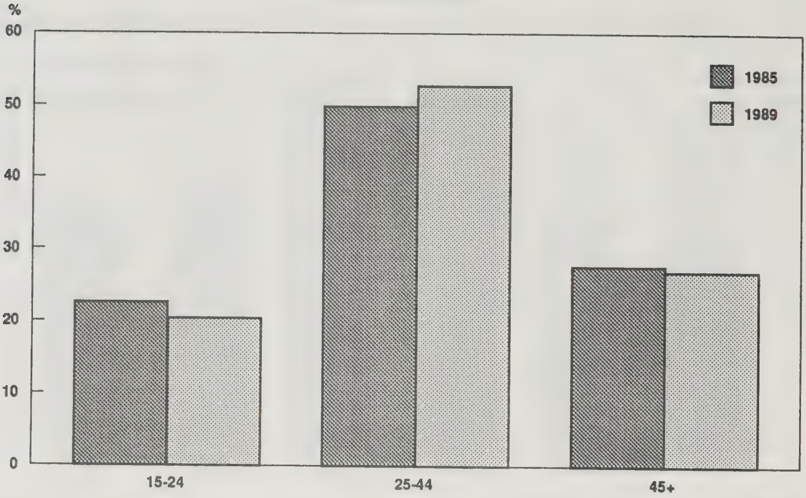
Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

The structure of the labour force has changed, reflecting the aging of the baby-boom generation and changes in the participation rates of certain demographic groups. The share of young workers aged 15 to 24 has fallen from 23 per cent of the labour force in 1985 to an estimated 20 per cent in 1989. The 25-44 age group, which has accounted for four-fifths of total growth since 1985, has increased its share from 50 to 53 per cent. The share of the labour force accounted for by workers aged 45 and over has declined marginally.

Women will account for an estimated 45 per cent of the labour force in 1989, up from 44 per cent in 1985. The increase in the share of women reflects rising participation rates. The number of two-income families has grown considerably, with the labour force participation of married women rising from 58 per cent in 1985 to an estimated 62 per cent in 1989. It is estimated that 64 per cent of women with pre-school children are now in the labour force in Ontario.

The average level of education of Ontario's labour force continues to rise, reflecting the higher educational levels of the baby-boom generation and the retirement of older workers. The proportion of the labour force with some post-secondary education has risen from 39 per cent in 1985 to an estimated 43 per cent in 1989.

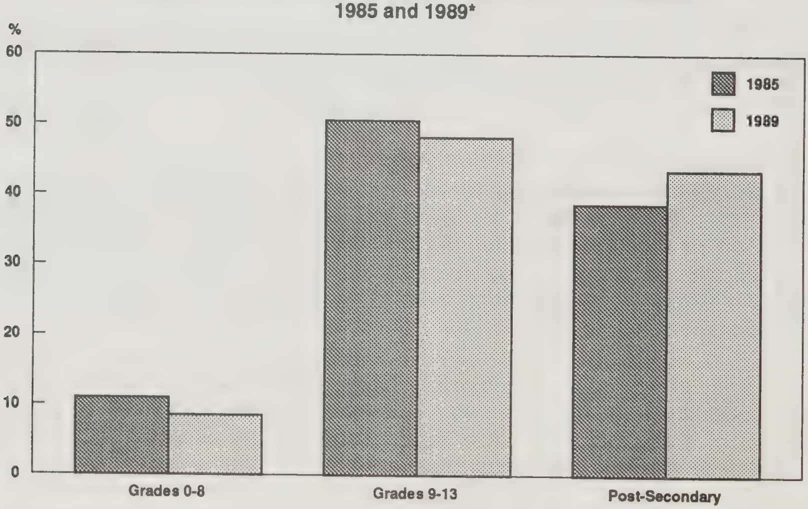
ONTARIO'S LABOUR FORCE BY AGE GROUP
1985 and 1989*



* January through September.

Source: Statistics Canada.

ONTARIO'S LABOUR FORCE BY EDUCATIONAL ATTAINMENT
1985 and 1989*



* January through September.

Source: Statistics Canada.

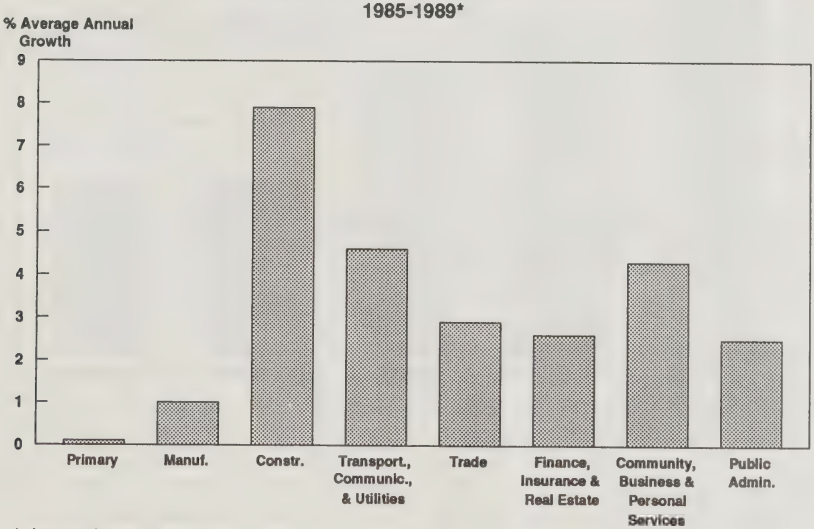
Employment

Ontario's Job Creation Record

Ontario's rate of employment growth has outpaced that of all other provinces over the 1985-1989 period, with an estimated average of 142,000 new jobs being created per year. Eighty-eight per cent were full-time positions and 12 per cent were part-time. Reflecting Ontario's tightening labour markets, the proportion of part-time employees who would prefer full-time employment has fallen from 22 per cent in 1985 to 15 per cent in 1989 to date.

Since 1985, employment in the service sector has increased by 20 per cent, almost double the 11 per cent growth in the goods-producing sector. As a result, the share of employment in the service sector has risen from 67.9 per cent in 1985 to an estimated 69.2 per cent in 1989.

EMPLOYMENT GROWTH BY INDUSTRY, ONTARIO 1985-1989*



* January through September.
Source: Statistics Canada.

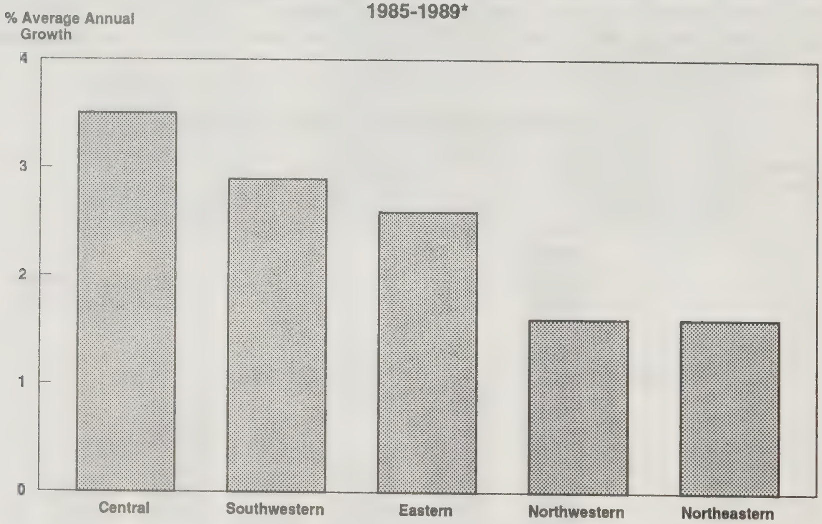
The service sector has accounted for 79 per cent of all new jobs created in Ontario since 1985. The largest employment gain has been in community, business and personal services. These industries created 304,000 new jobs, representing more than 42 per cent of all jobs created in Ontario during this period.

The number of jobs in manufacturing has increased by 49,000 over the 1985-1989 period to date. This represents an increase of five per cent, higher than in any of the major industrialized countries.

Of all the jobs created since 1985, 42 per cent have been in the managerial and professional category, and 92 per cent of those have been full-time positions. Over 60 per cent of the new managerial and professional jobs have been taken by women, reflecting their greater participation in the labour market, their increased education levels and the growth in the number of small businesses headed by women.

Regional Distribution of Job Creation
Employment growth has been distributed broadly among all regions of the province since 1985. Central and Southwestern Ontario have experienced the most rapid employment growth.

ONTARIO REGIONAL EMPLOYMENT GROWTH 1985-1989*



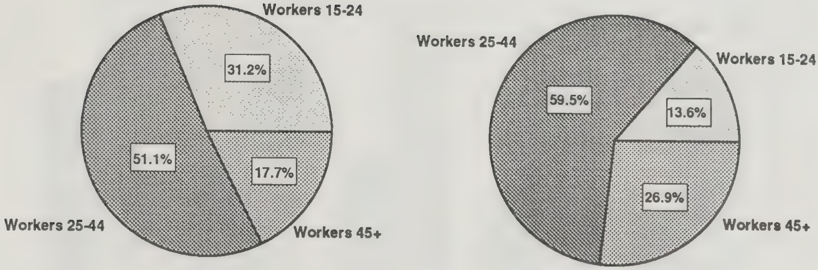
* January through September.

Source: Statistics Canada.

Unemployment

Age Profile of the Unemployed
While the unemployment rate of older workers (age 45 and over) is the lowest among demographic groups, older workers are over-represented among those who have been out of work for more than six months. In 1989 to date, older workers have accounted for 18 per cent of the unemployed, but have represented 27 per cent of long-term unemployment. The average duration of unemployment for older workers in Ontario has declined from 23.7 weeks in 1985 to 19.3 weeks in 1989 to date, while the duration of unemployment for youth has fallen from 12.5 weeks to 8.6 weeks. Given tighter labour markets, the concentration of long-duration unemployment among older workers suggests that their skills may be less portable than those of other demographic groups.

AGE PROFILE OF UNEMPLOYED
ONTARIO, 1989*



Share of Unemployment **Share of Long-Term Unemployment**

* January through September.

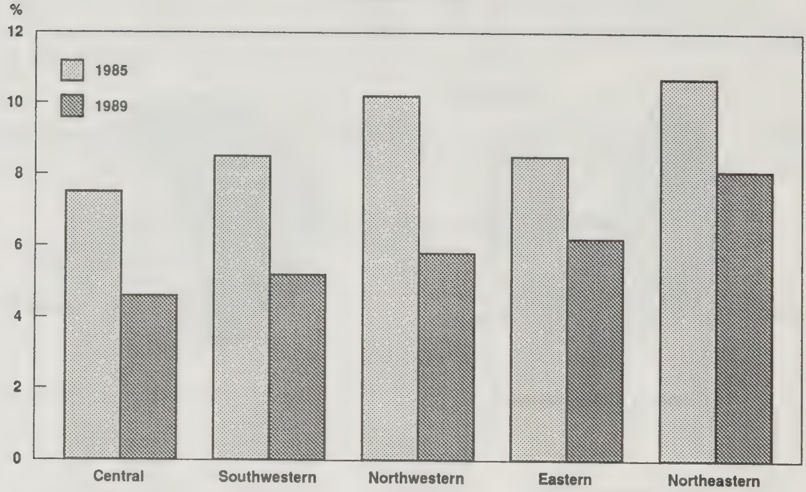
Source: Statistics Canada.

Strong demand for young workers, combined with reduced supply, is reflected in lower youth unemployment. The number of unemployed youth has dropped from 140,000 in 1985 to 83,000 in 1989 to date. Youth now account for 31 per cent of all unemployed persons in Ontario, compared to 37 per cent in 1985.

Layoffs
Major layoffs involving 50 or more workers have affected about 14,000 workers each year since 1985. Although the total number of employees affected has been stable over the period 1985 to August 1989, layoffs due to complete plant closures have increased slightly, indicating continued pressure on industries to adjust and restructure. Plant closures have occurred mostly in mature manufacturing industries and have affected older workers and long-service employees more severely than younger and more mobile workers. Laid-off older workers tend to experience longer periods of unemployment and greater difficulties finding re-employment.

Regional Dimension
Unemployment rates have fallen in all regions of Ontario. In Central Ontario, the unemployment rate is below five per cent. While unemployment rates in Northern and Eastern Ontario remain above the provincial average, they too have declined since 1985.

ONTARIO REGIONAL UNEMPLOYMENT RATES
1985 and 1989*



* January through September.

Source: Statistics Canada.

Skilled Labour Requirements

Many of the new and emerging jobs in the labour market require a broader range and higher level of skills than in the past. The federal government has estimated that 64 per cent of the new jobs created between 1986 and the year 2000 will require more than 12 years of education and training, compared to 44 per cent of current jobs.

The combined impacts of demographic, technological and economic change have resulted in shortages of skilled labour in certain occupations and market areas. For example, 50 per cent of respondents to a Canadian Federation of Independent Business survey cited shortages of qualified labour as a problem to their operations in 1988, compared to 30 per cent in 1985.

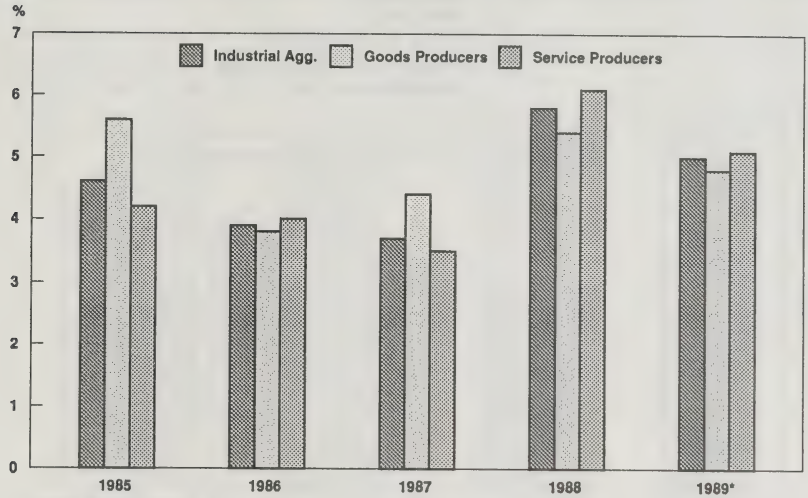
A recent study by the Ministry of Skills Development has identified 159 occupations as being in short supply in Ontario. Recruiting difficulties are most pronounced in such occupations as managers, engineers, engineering technicians, systems analysts, tool and die makers, and machinists. These shortages suggest a continuing need to upgrade and modernize the skills of the workforce.

Compensation Trends

Earnings

Average weekly earnings for paid workers in Ontario grew at an annual rate of 5.0 per cent in the first eight months of 1989. Between 1985 and 1989 to date, growth in average weekly earnings averaged 4.6 per cent per year.

ONTARIO AVERAGE WEEKLY EARNINGS INCREASES
1985-1989



* January through August.

Source: Statistics Canada.

For the second consecutive year, earnings growth in the service industries has outpaced that in the goods-producing industries. The trade sector and the transportation, communications and utilities sector have led the way, with increases of 6.1 and 5.5 per cent respectively.

Wage Settlements

In response to tight labour markets, the first two quarters of 1989 were characterized by intensified wage demands within large bargaining units. Ontario wage settlements covering 500 or more employees increased by 6.3 per cent, compared to 5.3 per cent in the same period in 1988. While this is significantly higher than the growth in average weekly earnings, wage settlement data cover only a small proportion of total employment. For example, agreements ratified in the first half of 1989 covered less than three per cent of Ontario's employed labour force.

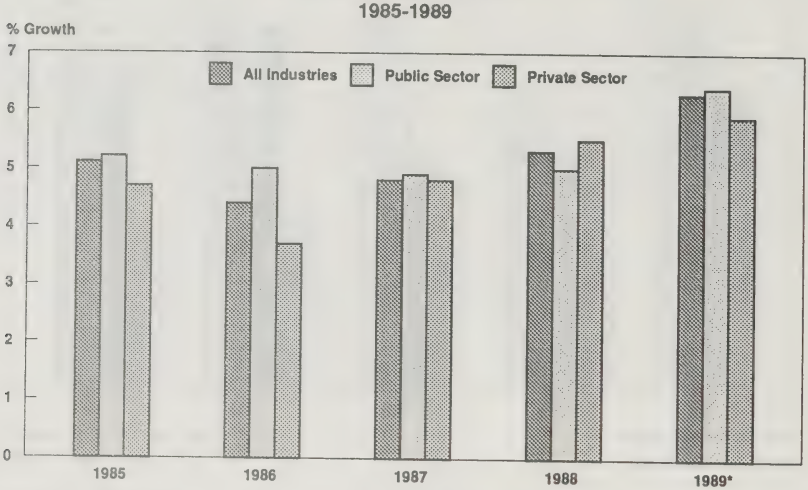
Wage settlements in Ontario continued to exceed Canadian settlements. Base wage rates in Ontario in the first half of 1989 increased by 6.3 per cent, compared to 4.8 per cent for Canada as a whole. The current Ontario-Canada differential is similar to patterns observed throughout most of this decade.

Collective bargaining activity in Ontario in 1989 is concentrated in the public sector, where increases averaged 6.4 per cent in the first half of the year compared with 5.9 per cent in the private sector. In 1988, public sector wage settlement increases averaged 5.0 per cent, compared with 5.5 per cent in the private sector.

In 1990, significant bargaining activity will occur in the private sector where major groups seeking to renew contracts include auto workers and construction unions. Wage pressures

may be moderated by employee concerns about job security in the face of international competition and by the expected slowdown in economic growth, particularly in construction.

ONTARIO WAGE SETTLEMENTS (OVER 500 EMPLOYEES) 1985-1989



* January through June.

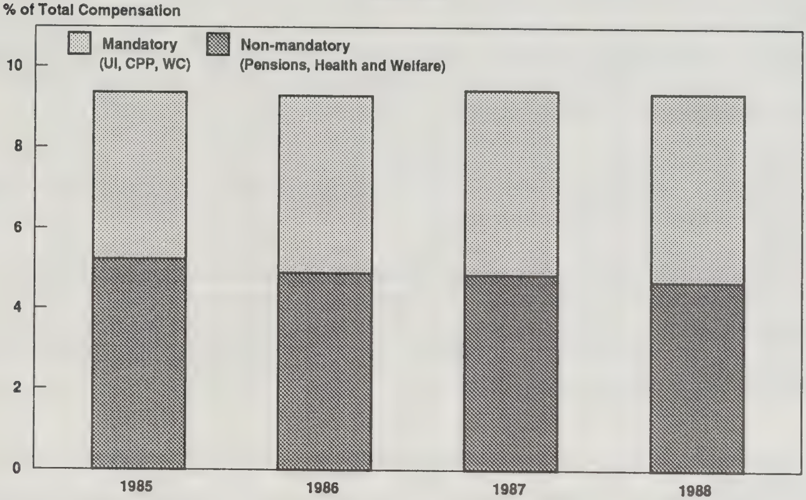
Source: Labour Canada and Statistics Canada.

Non-Wage Compensation

Non-wage compensation consists of mandatory and non-mandatory employer payments made for the benefit of employees. Mandatory payments include Canada Pension Plan (CPP), Unemployment Insurance (UI) and Workers' Compensation (WC) premiums. Non-mandatory payments are for the Ontario Health Insurance Plan (OHIP) and private health and pension plans. In 1988, non-wage compensation constituted 9.4 per cent of labour income. This proportion has not varied significantly since 1985.

Throughout the 1980s, the mandatory component of non-wage compensation has grown faster than non-mandatory payments. Mandatory items accounted for 50 per cent of total non-wage payments in 1988 compared to 33 per cent in 1980. Increases in WC and UI payments explain most of this increase. The mandatory component of non-wage compensation is likely to continue to grow as a result of federal proposals to increase UI premiums. The introduction of the Ontario Employer Health Tax will also increase mandatory payments but will be offset by a decline in non-mandatory payments due to the abolition of OHIP premiums.

MANDATORY AND NON-MANDATORY COMPONENTS OF NON-WAGE COMPENSATION IN ONTARIO 1985-1988



Source: Statistics Canada.

The Sectoral Outlook

Overview

Most sectors of the economy will expand throughout the 1990-1993 period, but more slowly than in the 1985-1989 period. This reflects slower economic growth for the economy as a whole.

In 1990, the manufacturing sector is expected to grow more slowly than other sectors, while construction activity will fall. Service sector growth will exceed the average in 1990.

For the 1991-1993 period, the manufacturing sector is expected to rebound, based on high growth in the transportation equipment and investment goods industries. Little real growth is forecast for resource-based industries. Consumer products industries will grow less rapidly than other manufacturing, as will the service sector, partly due to the introduction of the federal Goods and Services Tax.

Sectoral Outlook — **Table 6**

	1988		Real Output Growth		
	Employment	**Share of Real Output**	**1989**	**1990**	**1991-93**
	(000s)	%	%	%	%
Primary Sector	170	4.1	3.7	2.4	2.1
Manufacturing	1,028	26.8	1.7	1.0	3.2
Resource-Based	141	3.5	1.8	(0.1)	0.3
Transportation Equipment	173	5.0	0.2	1.7	5.8
Investment Goods	175	5.4	3.9	2.2	4.1
Intermediate Products	276	7.2	0.9	0.9	3.1
Consumer Products	263	5.7	2.1	0.3	1.7
Construction	291	7.1	5.4	(0.6)	3.1
Utilities	55	2.4	4.1	3.8	3.0
Service Sector	3,318	59.6	2.9	2.6	2.9
Total	4,862	100.0	2.8	2.0	3.0

Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

Agriculture

During the 1980s the Ontario agricultural economy has been strained by a combination of over-capitalization, disruptive foreign agricultural policies, fluctuating livestock prices and low grain prices. The nearly 30 per cent of the industry that operates under supply management has fared well, but other sectors have suffered. Uncertainty in those sectors without the security of cost-related product pricing has led to an emphasis on reducing liabilities. Dairy farmers, who produce within a supply management system, have been increasing the size of their operations and assuming increased levels of debt.

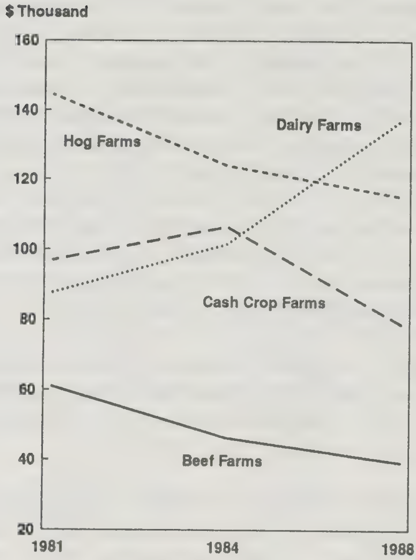
Real agricultural output in 1989 is expected to increase by 3.0 per cent from the drought-depressed levels of 1988, primarily as a result of improved weather. Farm incomes are not expected to show similar increases due to a combination of rising production expenses and lower crop prices in response to increased world supplies of grains and oilseeds.

Over the next four years real agricultural output is expected to grow at an average annual rate of 1.8 per cent. Rising production costs and declining prices for **cereals and oilseeds** will tend to discourage production increases. **Red meat** production is expected to increase in 1990 and 1991 in response to lower feed costs and rising hog prices.

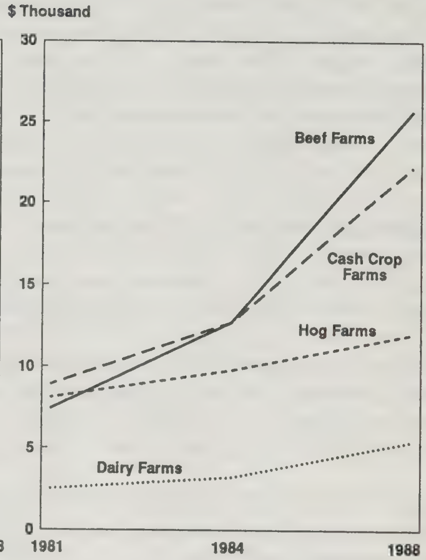
The joint federal and provincial Grape Acreage Reduction Program has been largely responsible for a 20 per cent drop in grape production in 1989. This reduction is expected to offset the increased production of other **fruits and vegetables** resulting from improved growing conditions.

The 1989 target for the Ontario **tobacco** harvest has been set at 153 million pounds, up 14 per cent from the 1988 harvest. The 1989 production level is seen as a short-term production peak to provide for increased exports and some stock rebuilding. The current three-year accord with manufacturers provides for smaller crops in 1990 and 1991.

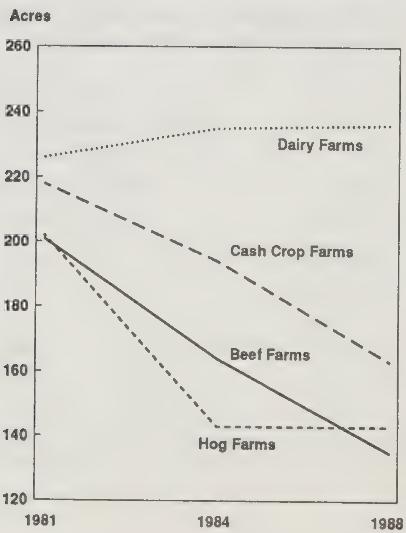
AVERAGE FARM LIABILITIES



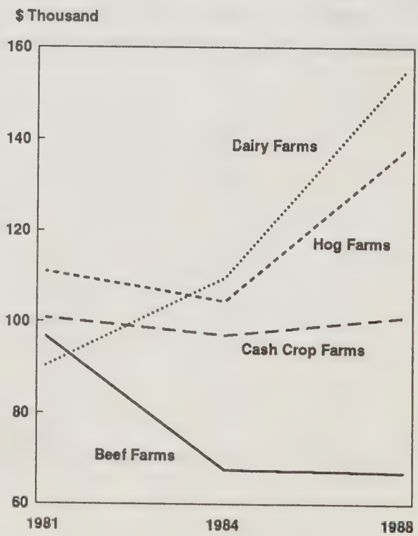
AVERAGE NET OFF-FARM INCOME



AVERAGE ACRES FARMED



AVERAGE FARM SALES



Source: Farm Credit Corporation.

Resource and Resource-Based Industries

This group includes logging, forest products, mining and primary metals.

Ontario's **forest industries** — wood, pulp, paper and allied industries — employed about 84,000 in 1989, an increase of about three per cent over the previous year. Forest industry employment is particularly important in Northwestern Ontario, where it accounts for some 67 per cent of the region's total employment in primary and manufacturing activities.

Activity in the **wood products** sector is driven by new residential construction and renovation. Ontario housing starts, although down from a record level of 105,000 in 1987, are still relatively strong. They are expected to reach 91,000 this year, and 84,000 next year. The slower pace of new home construction in 1990 will cause a softening in wood products sales. Modest growth is expected to resume during 1991-1993.

Within the **pulp and paper** sector, pulp producers continue to enjoy strong demand and rising prices, but newsprint demand and prices have slackened. A large increase in North American newsprint capacity is beginning to come onstream. With the slower rate of growth in the United States and Canadian economies, this excess capacity is likely to depress operating rates and prices for the next few years.

Mining and primary metal industries employ 90,000 in Ontario. Nearly half of this employment is concentrated in Northeastern Ontario, where it represents almost 54 per cent of the region's total employment in primary and manufacturing activities.

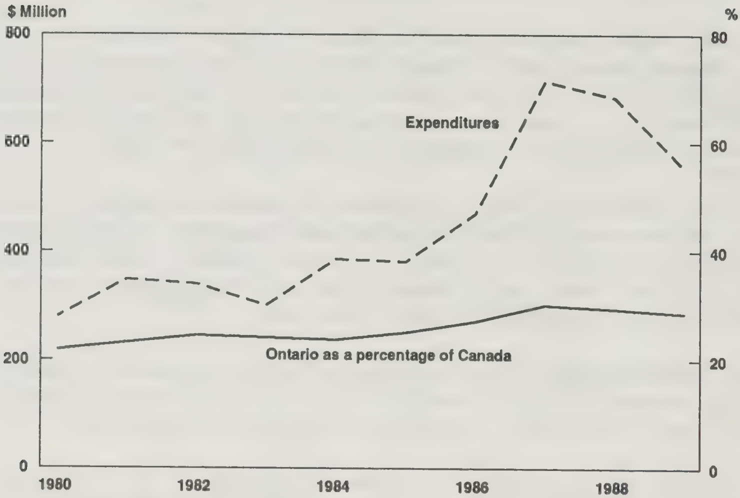
Spending intentions for exploration and mine-site development in Ontario for 1989 total $554 million, down from $683 million in 1988 and a peak of $714 million in 1987. This reflects less favourable federal tax treatment of flow-through financing of exploration and the completion of a number of new mine development projects.

The outlook for Ontario's leading minerals remains generally favourable. Although the price of gold has slumped to about $360 U.S. per ounce, many mines are realizing higher prices because of forward sales. Based on 1989 production plans, Ontario gold output is expected to increase by 28 per cent. Some new mines are also expected to come into production in 1990.

The recent high prices for base metals — nickel, copper and zinc — are not expected to last as the global economy enters a period of slower growth, and some additional world mine capacity comes on stream. However, prices are still expected to ensure reasonable profit levels for Ontario's low- to medium-cost mining operations. More moderate and stable metal prices may also reduce the threat of substitution by cheaper materials and will benefit metals' longer-term prospects.

While the spot market price for uranium has fallen by one-third over the past year, most of Ontario's production is still being sold at higher prices under long-term contracts with Ontario Hydro and other utilities. Producers are reducing costs to compete with low-cost mines in Saskatchewan.

ONTARIO EXPLORATION AND MINE DEVELOPMENT EXPENDITURES 1980-1989



Source: Statistics Canada.

Ontario's **steel** production continued its upward trend in 1989, buoyed by demand from the automotive sector and a modest recovery in the energy sector. Demand is expected to level off in 1990.

Ontario's steel industry accounts for about 78 per cent of Canadian steel production and employs about 45,000. Twenty per cent of Ontario's $7.9 billion steel production is exported to the United States.

Rationalization and modernization are continuing as the outlook for steel consumption remains relatively flat. The removal of United States restraints on steel imports, expected in 1992, will expand Ontario steel producers' market opportunities. Ontario mills currently have a small advantage due to lower labour and material costs compared to their United States counterparts.

Transportation Equipment

Motor vehicle assembly and parts account for over two-thirds of transportation equipment output and employment. Aerospace, bus, and railway equipment manufacturing comprise the remainder of the sector. This sector contributes 19 per cent of Ontario's manufacturing output.

The performance of Ontario **motor vehicle and parts** manufacturers is dependent on market conditions in the United States. Ontario manufacturers export approximately 90 per cent of production, with the United States receiving 98 per cent of these exports. Because the Ontario industry is a fully integrated part of the North American industry under the Auto Pact, it is much more export-oriented than its Japanese or West German counterparts.

Despite an estimated seven per cent decline in 1989 North American sales, Ontario motor vehicle output is expected to grow slightly due to continuing increases in Ontario production capacity and declines in North American imports.

North American sales are forecast to decline a further three per cent in 1990, reflecting slower economic growth. Nevertheless, Ontario's auto industry is expected to show an increase in output as new plants increase production to full capacity.

In the medium term, Ontario motor vehicle output is expected to exhibit strong growth. This reflects a gradual recovery in United States sales following 1990 and Ontario's expanding share of North American assembly capacity.

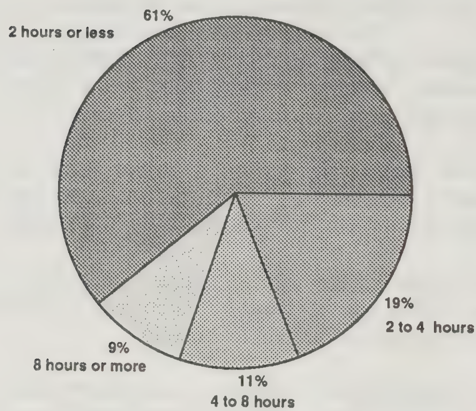
Ontario's motor vehicle parts industry, which is nearly three times as large as the assembly industry in output and employment, increased output significantly in 1988 to meet demand from increased North American vehicle production. In 1989, motor vehicle parts output is forecast to decline marginally, reflecting lower North American production levels induced by declining sales.

In the medium term, the Ontario parts industry is expected to grow strongly, reflecting the recovery in North American vehicle sales after 1990 and the shift to higher value-added vehicles. The sector will benefit from proximity to a growing assembly market especially as a result of recent investments in assembly capacity in Canada.

Shifts in production technologies and systems will continue to cause restructuring in the auto parts industry with associated plant closings, openings or expansions. The success of individual firms will depend on their ability to meet assemblers' price, quality and delivery requirements relative to their competitors.

The continued implementation of the just-in-time production system — in which parts are delivered to assembly plants when they are required, eliminating the need for warehousing — will be a key factor in determining the future performance of the Ontario parts sector. Ontario parts plants are well positioned to benefit from just-in-time production. Forty-five per cent of North American assembly capability is within two hours' delivery time by truck, and 75 per cent is within eight hours. Most of the Ontario parts industry already specializes in just-in-time components and competes primarily with plants in the Great Lakes region rather than with low-wage jurisdictions such as Mexico.

ONTARIO AUTO PARTS PRODUCTION BY JUST-IN-TIME DELIVERY CATEGORY 1986



Source: Roger Miller (Université du Québec), Statistics Canada and Ontario Ministry of Treasury and Economics.

In the **rubber** industry, closures of major tire plants reduced output in 1988. Recent investments in plant and technology such as at Goodyear's new Napanee plant are expected to improve the outlook for output and employment.

The **aerospace** segment of the transportation equipment sector is experiencing robust growth and is operating at close to full capacity. Ontario manufacturers of aircraft and components are benefitting from increasing global demand due to the growth in commuter airline traffic and fleet replacement by major airlines. A growing order backlog indicates that strong activity in this segment is assured over the forecast period.

Investment Goods

Investment goods include industrial electronics, machinery, scientific equipment and office furniture. In 1988, this sector accounted for 20 per cent of Ontario manufacturing output. Nearly half of this sector's production is destined for the world market. Investment goods comprise 12 per cent of Ontario's total exports to the United States, 26 per cent to Western Europe and 32 per cent to other countries.

As a result of higher levels of business investment, global rationalization and automation in the manufacturing sector, the investment goods industries experienced strong growth in 1988 and 1989. As North American business investment in machinery and equipment is expected to slow, growth will moderate over the medium term.

Growth in the **industrial electrical and electronics** sector — which includes telephones, computers, electric transformers, and similar goods — is being driven by business investment and modernization plans to improve productivity. Since 1985, the value of Ontario shipments in this sector has increased by 26 per cent in constant dollars, while Ontario's manufacturing shipments as a whole have increased by 13 per cent.

The communications equipment sector is internationally competitive, and reduced tariffs are not expected to affect the performance of the industry adversely. Stronger growth is expected in the markets of the newly industrialized countries as the North American market becomes saturated with digital technology. Softening in the telecommunications market and a higher exchange rate will lead to reduced but healthy growth over the forecast period.

The **machinery** industry has rebounded due to restructuring and rationalization of the manufacturing sector. Increased output in the machinery sector in 1988 and 1989 has reflected the healthy levels of business investment in plant and equipment. Strength in the resource-based industries has improved the outlook for manufacturers of mining and construction machinery. Overall growth in the industry will slow as business investment moderates over the medium term.

The **scientific equipment industry** supplies a broad range of products in computer-based control, automation, monitoring and supervisory systems used in industry. The majority of Canadian-owned instrumentation companies are competitive in export markets within narrow product and technology niches because of their relatively small size, low overhead costs, shorter delivery times and flexibility. Over the medium term, growth is expected to be comparable to that of the manufacturing sector as a whole.

Exports to the United States have played an important role in Ontario's **office furniture** industry. In general, the industry is competitive with United States producers in terms of design, quality and service. Until recently, higher domestic production costs have been offset by favourable exchange rate movements. Growth is forecast to exceed the manufacturing average to 1993.

Intermediate Products

Intermediate products include non-metallic minerals, fabricated metals, chemicals, plastics, commercial printing and petroleum refining. The sector is oriented toward domestic business activity, although in some industries trade is significant with northern states. Intermediate products constitute 27 per cent of manufacturing production in Ontario.

In recent years, intermediate products industries have benefitted from the continued expansion of the economy. Excluding petroleum refining, which has been affected by sales of fuel-efficient automobiles, real shipments in this sector have increased 19 per cent since 1985, significantly faster than the 13 per cent for manufacturing as a whole. Recent growth in profits, industry modernization and export-oriented restructuring provide the basis for continued growth in intermediate products industries averaging 3.1 per cent annually through 1993.

Recent rapid growth in **non-metallic minerals** (primarily cement and concrete) is expected to moderate over the 1990-1993 period as growth in residential construction slows. The cement industry is successful in exporting to the United States due to market accessibility, insufficient capacity in border states and access to limestone, water transportation and low-cost electricity. Elimination of United States tariffs on concrete products over the next five years will allow Ontario producers to take advantage of substantial economies of scale and cost savings in this capital-intensive industry.

The strong growth in shipments of **fabricated metal** products has slowed since 1987. Output has been supported by the buoyant construction and automotive sectors and substantial increases in machinery and equipment investment. Over the forecast period, annual growth will exceed three per cent. Growth in industry segments dependent on housing construction will moderate over the forecast period as the growth of residential construction declines.

The **chemical** industry is benefitting from global restructuring, increased business investment and rising demand. The appreciation of the Canadian dollar over the past year has exerted competitive pressure on some firms. Following a period of restructuring through 1990, growth is expected to resume over the longer term.

Over the medium term, growth in **plastics** output will slow. In addition to a return to more normal demand growth, technological innovations in packaging and recycling will continue to affect the market for plastic packaging.

Since 1985, **commercial printing** has been growing at 5.9 per cent annually. In 1987 Ontario exported 31 per cent of shipments and accounted for 53 per cent of Canadian exports. The outlook is for slower growth over the forecast period as business activity moderates.

Demand for **petroleum** products will grow modestly reflecting the impact of conservation, efficiency improvements and substitution of alternative fuels.

Consumer Products Industries

This group includes food processing, beverages, textiles and apparel, consumer-related printing and publishing, consumer appliance industries, and household furniture.

Consumer spending on these goods has increased by less than consumer spending on other items such as recreation, education, transportation, automobiles and housing. As a result, the share of consumer spending on consumer products has declined from 42 per cent in 1970 to 35 per cent in 1987. In addition, domestic producers are slowly losing market share to importers.

The Ontario **food processing** sector is expected to continue to grow slowly along with population growth in its primary markets in Ontario and the rest of Canada. Stiff import competition is limiting growth in the fruit and vegetable processing industry. Specialty food processors are showing rapid growth as many firms have successfully developed markets for high value-added products such as convenience foods.

The **beverage** industry will show only slight growth marked by the quickly expanding soft drink industry and the slower growing beer industry. Continued market softening is expected for the spirits and wine industries.

Following significant restructuring in recent years, production in the **tobacco** manufacturing industry is forecast to decline modestly over the medium term.

Growth in the Ontario **textile and clothing** industries is expected to slow and is dependent on the industries' success in a narrow range of products geared mainly to North American markets. The textile industry faces slower demand from the home furnishings market in the medium term. Competition from imported textiles may become stiffer if the federal International Trade Tribunal reduces tariffs on foreign products. If enacted, lower tariffs on textiles would benefit the clothing industry, which nevertheless is facing slower consumer demand and strong competition from low-wage countries in the medium term.

In contrast to most consumer products industries, **consumer printing and publishing** has been growing quickly. As the tariff protection that printing and publishing has enjoyed will lessen in the future, companies are undertaking major restructuring actions, including rationalization and mergers. In the medium term, growth is expected to slow but to remain above the average for consumer products. Demand for reading materials will continue to grow, and Canadian printing industries are finding niche markets in Canada and the United States that large-scale firms in the United States cannot effectively serve.

The housing boom, increased personal income and the novelty of microwave ovens have generated a mini-boom in **consumer appliance** products in the last several years. The industry is expected to enter a period of much slower growth as housing construction levels off and demand for consumer appliances becomes saturated. Moreover, Canada will have to compete with United States plants which in many cases are more specialized and have larger production scales.

After several years of growth based largely on the housing boom, the **household furniture** industry will likely slow down starting in 1990. Canadian household furniture firms are less automated than their United States counterparts. Some are more competitive in market segments where design rather than price is the customer's main concern.

Construction

The construction industry has been one of the strongest performers during the current economic expansion. The industry has benefitted from the strong demand for housing and from commercial and industrial projects.

During 1989 activity has begun to moderate. Growth in business investment and housing has been weaker than in 1988. Commercial, institutional and industrial starts have declined. There has been a slowdown in major new capital investment announcements to offset the completion of large automotive, nuclear, and commercial projects. In 1990, real output in the construction sector will decline slightly.

Over the medium term, performance in the construction sector is expected to match that of the economy as a whole. Construction activity will benefit from the anticipated return to stronger economic growth and from a stabilization in housing starts.

Utilities

The utilities sector will be restrained by the general slowdown in housing construction but will grow in line with the overall economy in 1990. Over the medium term, efforts directed at energy conservation and environmental protection will have a moderating influence on this sector.

Investment by Ontario Hydro, which dominates activities in the electricity sector, will decrease in 1990 and 1991 and will increase marginally in 1992. This investment pattern reflects the completion of the four-unit Darlington nuclear generating station and major transmission projects in Southwestern and Eastern Ontario. The decline in investment in the electricity sector may be offset by higher investment in natural gas pipeline and compression facilities to accommodate increasing gas exports to the United States via Ontario.

Service Sector

The service sector accounts for approximately 60 per cent of total provincial output and nearly 70 per cent of employment. Service activities include transportation and communications; wholesale and retail trade; banking and insurance; health care; education; services to business management; and public administration.

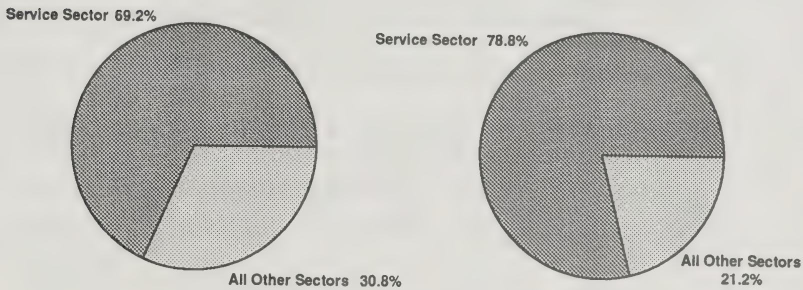
In recent years, growth of service sector output has been roughly comparable to the growth of output in the goods-producing sector. However, service sector industries are less cyclical than goods-producing industries. As the economy continues to experience decelerating growth in 1990, service sector output growth is expected to be stronger than output growth for the goods-producing industries. Over the 1991-1993 period, service sector output growth is expected to lag behind growth in the goods sector of the economy, as consumer spending on services is expected to be adversely affected if the GST is enacted as proposed.

Over the medium term, the share of overall employment attributable to the service sector is expected to continue growing, although not as rapidly as during the past decade. Factors constraining more rapid employment growth in services include the imposition of the proposed GST and the difficulty in recruiting entry-level workers.

The effect of the proposed GST is not expected to be uniform across the service sector. Sectors which have been most lightly burdened by the manufacturer's sales tax on their purchased inputs and which will now bear the GST will be hardest hit, along with their suppliers. These would include the tourism and hospitality industries; amusement and recreational services; accounting, law, and investment counselling services to individuals; and personal services such as hairstyling, cleaning, and household services.

SERVICE SECTOR SHARE OF EMPLOYMENT AND NEW JOBS
1985-1989

EMPLOYMENT SHARE 1989* **NEW JOBS CREATED 1985-1989***



* January through September.

Source: Statistics Canada.

Financial Services

The financial services sector includes the banking, trust, brokerage and insurance industries. Activity has been strong over the past four years, with employment levels rising by more than 25,000. This sector has encountered a number of challenges, including the October 1987 stock market crash; growing debt levels, particularly among consumers and Third World countries; and the need to restructure and change strategies in response to increased competitive pressures and regulatory reform. Over the forecast period, performance in financial services is expected to be strengthened by the introduction of new financial products and innovations and continued productivity growth. Real output growth in financial services is expected to exceed that of the overall service sector.

The financial services sector will be largely exempt from the proposed GST. Financial services such as lending money, issuing life insurance, or underwriting equities will not be subject to the tax. However, the inputs that financial institutions use in providing exempt services will be taxable, and financial institutions will not be able to claim offsetting input tax credits since they will be considered to be the final consumers of these inputs. This will increase costs and may weaken the international competitive position of many Canadian financial institutions.

Business Services

The business services sector includes computer, accounting, advertising, personnel, architectural, engineering, legal and management consulting activities. It is an important producer of intermediate input services which are used in the further production of goods and services. Nearly nine per cent of employment in the service sector is attributable to the business services component. Since 1985, the business services sector has enjoyed the fastest employment growth rate among all sub-groupings within the service sector.

Ontario's Position in a Changing World Economy

The International Context

The past decade has witnessed a strengthening in the ties between Ontario's economic performance and developments at the global level. The reality of expanding global interdependence is reflected in the growth of Ontario's trade and investment flows. These have extensive implications for Ontario's economic performance.

Some of the international forces affecting the province include:

- the impressive economic success of Japan and the Newly Industrialized Economies (NIEs), increasing the competitive pressure on key Ontario industries;
- rapid shifts in the development and diffusion rates of new technology;
- the globalization of world financial markets, reducing national flexibility in setting monetary policy; and
- the increasingly pivotal role of large multinational corporations in coordinating production, research spending and intra-industry trade.

The Canada-United States Free Trade Agreement provides a new framework for trade between the two countries, including the phase-out of tariffs over the next decade. The agreement provides for further negotiations to develop a new set of trade rules governing anti-dumping and subsidy-countervail actions. It also establishes a Select Auto Panel to study prospects for the North American motor vehicle industry. While evidence of the agreement's overall effect is not yet available, United States actions in 1989 against Canadian producers of pork and steel rail confirm that the agreement has not substantially increased Canada's security of access to the United States market.

At the multilateral level, negotiations at the Uruguay Round of the General Agreement on Tariffs and Trade (GATT) are scheduled for completion at the end of 1990. They seek to liberalize world trade further and to extend international trade rules to agriculture, services and the protection of intellectual property such as copyright and patents.

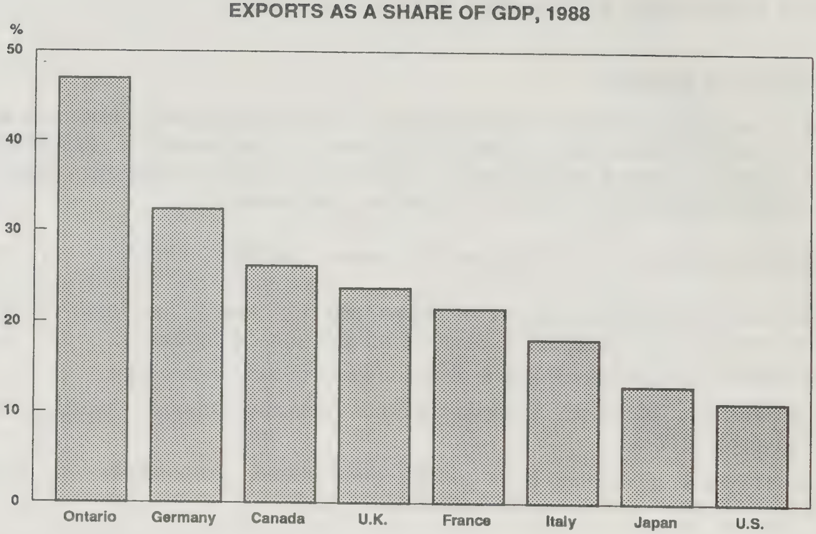
The European Community is moving towards completion of a single internal market. By 1992, most of the existing barriers to the movement of goods, persons and capital between the twelve member states are expected to be phased out, creating a single market of 320 million people.

Ontario's International Trade

Ontario's exports as a share of GDP surpass those of each of the Group of Seven countries. At the same time, Ontario is less dependent on international commerce than some European Community nations such as Belgium.

In 1988, 32 per cent of Ontario's exports went to other provinces while 68 per cent were international exports. Over the decade, Ontario's international exports have grown faster than its interprovincial exports.

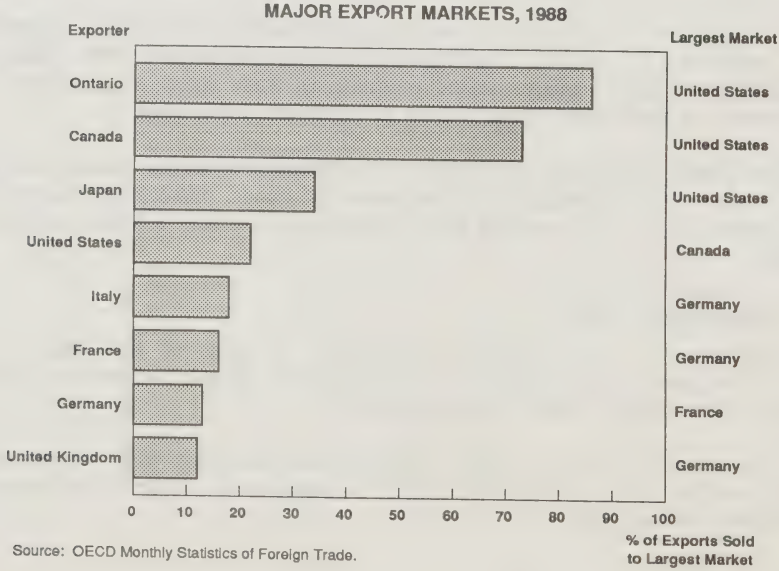
EXPORTS AS A SHARE OF GDP, 1988



Source: OECD, Statistics Canada and Ontario Ministry of Treasury and Economics.

Ontario exporters continue to rely heavily on the United States market, which purchased 86 per cent of the province's international exports in 1988. Since the early 1980s, the share of Ontario's exports directed along north-south lines has increased. The United States is also the principal supplier of Ontario imports, accounting for three-quarters of Ontario's imports in 1988.

MAJOR EXPORT MARKETS, 1988



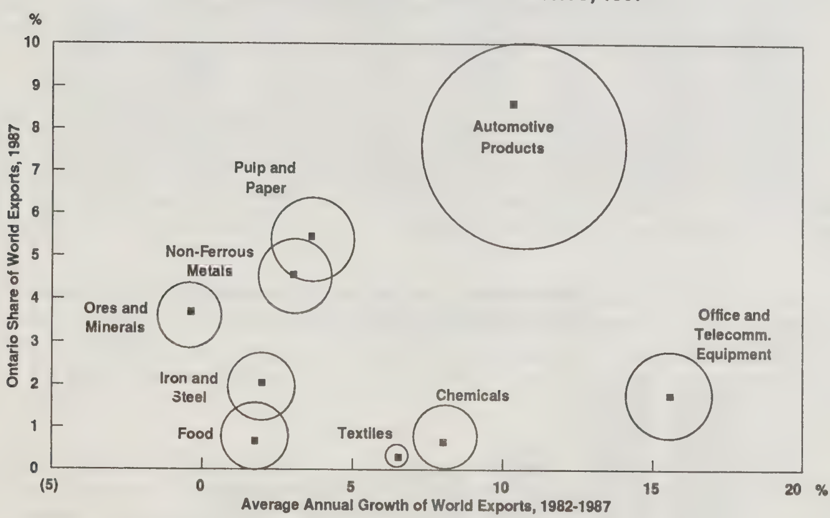
Source: OECD Monthly Statistics of Foreign Trade.

The automotive sector, which accounted for almost half of exports from the province in 1988, dominates Ontario's trade in manufactured goods. Ontario's strength in this sector has coincided with a remarkable expansion of world trade in motor vehicles. International shipments of cars and trucks have grown by an average of ten per cent per year since 1982, and Ontario holds a significant share of the global market.

Ontario's leading exports of high-technology goods are office equipment and telecommunications equipment. World trade in these two areas has grown even more rapidly than in autos, expanding at an average annual rate of more than 15 per cent since the early 1980s. However, Ontario's share of the world market for these products is comparatively small.

Ontario's world market share is much larger for resource-based exports such as iron and steel, ores and other metals and mineral products. World demand for these commodities has grown slowly since 1982. Ontario producers continue to face strong competition from mineral and metals producers in the developing countries. Excess capacity remains in the steel industry in both developed and developing countries.

ONTARIO'S SHARE OF WORLD EXPORTS, 1987



Note: Size of circle is proportional to Ontario exports.

Source: GATT and Statistics Canada.

International Comparisons

Recently the World Economic Forum and the IMEDE, two Swiss-based organizations, released a report on the economic potential and competitive status of a number of industrialized countries.[1] Canada, along with Japan, Switzerland, and the United States,

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1 World Economic Forum and the International Management Development Institute, *The World Competitiveness Report*, 1989.

was ranked among the most attractive countries as a location for economic activity. Compared to an earlier survey, Canada showed improvements in the macroeconomic and business environment and in industrial efficiency, while continuing to face challenges in its ability to innovate and to adapt to international trends. While the report does not rank individual provinces, the results for Canada reflect favourably on Ontario as the leading province in manufacturing and finance.

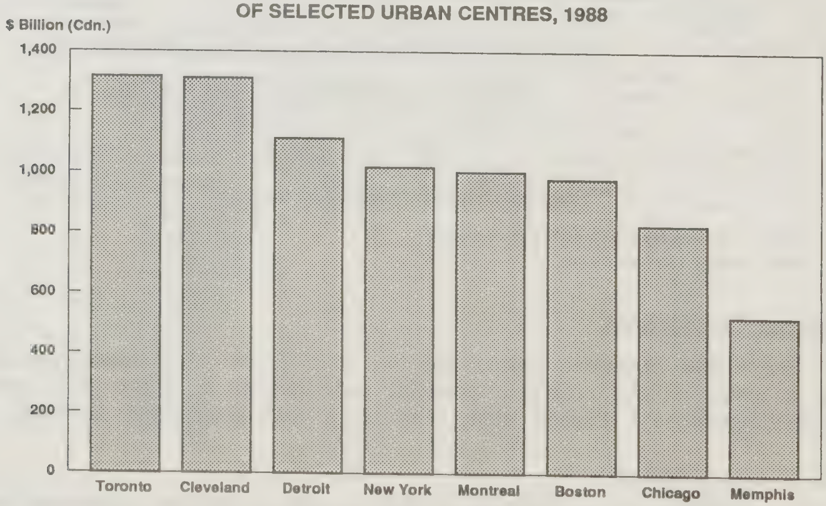
Ontario's attractiveness as a location for both existing business and new enterprises is affected by a number of economic factors, including:

- location in the North American market;
- labour compensation;
- capital investment and productivity;
- industrial R and D effort; and
- energy costs.

Location in the North American Market
Ontario manufacturers have a strong locational advantage within the Canadian market. The Ontario economy itself is the largest in Canada and is centrally located. The advantage is even stronger for investment goods and intermediate products manufacturers, who have access to a concentrated client base: 53 per cent of Canadian manufacturing activity is in Ontario.

Ontario is also favourably positioned with respect to the United States market, with ready access to both the United States midwest and the United States Atlantic seaboard. Toronto's one-day trucking access to consumer markets in North America exceeds that for any major city. As well, the Oshawa-to-Windsor corridor ranks favourably as a just-in-time location for industries such as auto parts.

TOTAL HOUSEHOLD INCOME WITHIN 400 MILES
OF SELECTED URBAN CENTRES, 1988

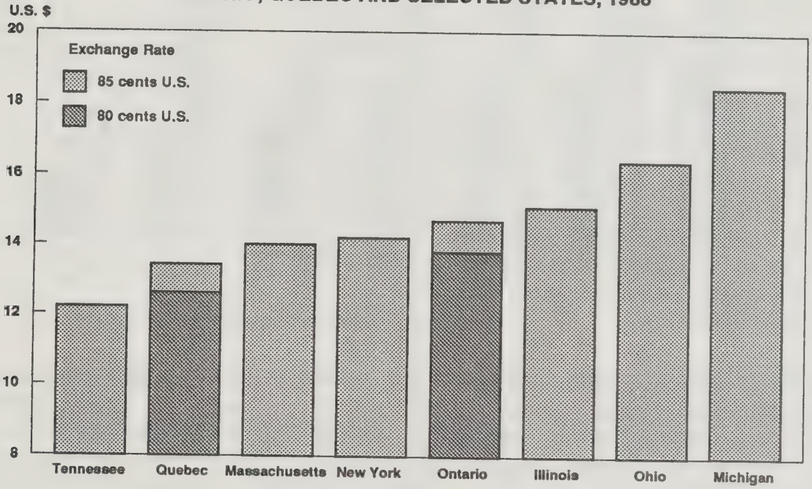


Source: Compusearch Market and Social Research Limited and Ontario Ministry of Treasury and Economics.

Labour Compensation

During 1989 the exchange rate has been close to 85 cents U.S. At this level, Ontario's hourly compensation for production workers remains comparable to that in most of the Great Lakes states, but is higher than in states such as New York and Massachusetts. Ontario would rank third in labour costs, behind Tennessee and Quebec, if the exchange rate were to return to the 80 cent level.

HOURLY MANUFACTURING COMPENSATION
ONTARIO, QUEBEC AND SELECTED STATES, 1988



Source: Statistics Canada and U.S. Bureau of Labor Statistics.

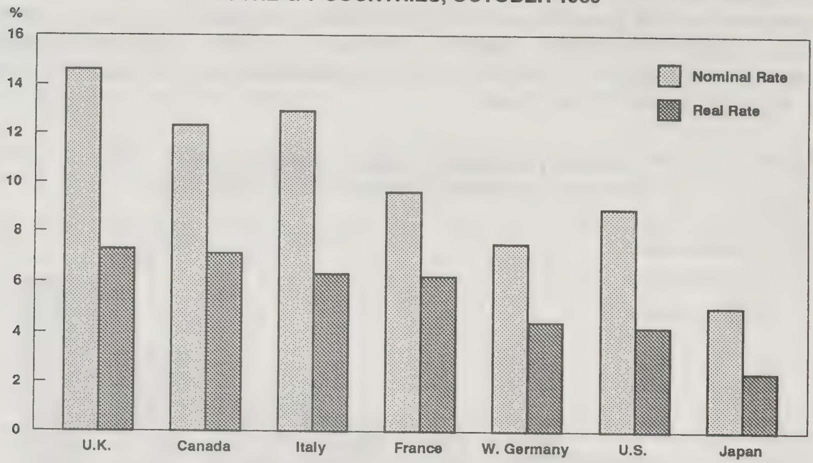
Labour compensation includes both wages and benefits. In the United States a major benefit is health care, with employers' average medical care premiums per worker now at $3,117 U.S. or 13.6 per cent of payroll compared to $1,453 U.S. or 7.9 per cent of payroll in 1984. By comparison, Ontario's Employer Health Tax will range from 0.98 to 1.95 per cent of payroll.

Capital Investment and Productivity

Ontario manufacturers face a disadvantage compared to their United States competitors because interest rates, especially short-term rates, are higher in Canada. These rates discourage capital investment.

Canada's short-term real interest rates are among the highest of the G-7 countries. As a result, borrowing has been discouraged and domestic demand has been dampened. The differential between Canadian and United States short-term real rates has risen over the past year to about three percentage points.

SHORT-TERM INTEREST RATES
IN THE G-7 COUNTRIES, OCTOBER 1989

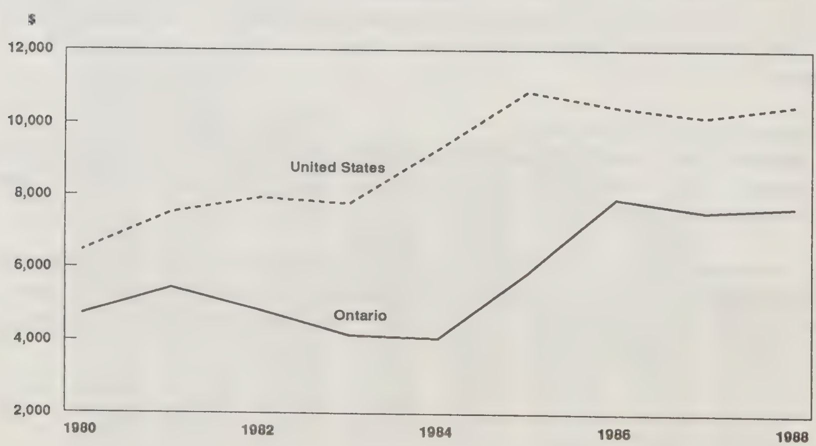


Note: Real Rate = Nominal Rate - Inflation Rate.

Source: The Economist.

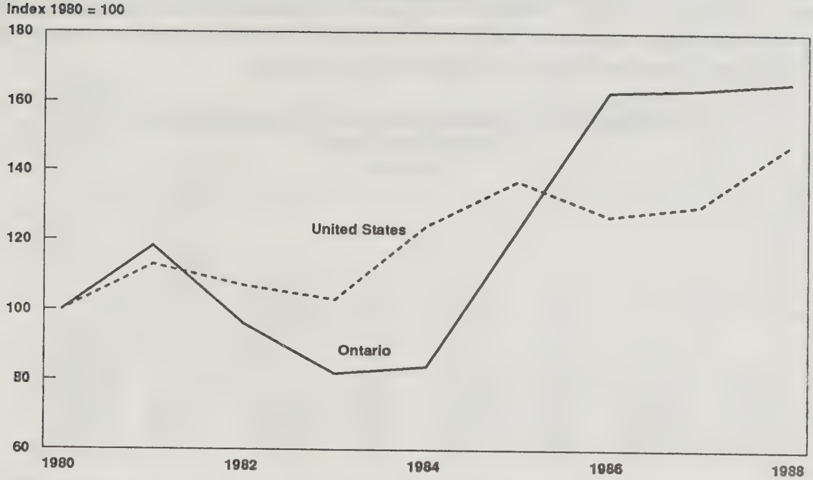
During the 1980s new capital investment per worker in Ontario, expressed in common currency, has been lower than in the United States. This reflects lower United States interest rates, a more severe cutback in the United States manufacturing labour force in basic industries, and investment related to increasing United States defence production. Despite these disadvantages, the rate of growth in Ontario's manufacturing investment has outpaced that of the United States since the mid-1980s.

CAPITAL EXPENDITURES PER WORKER IN MANUFACTURING
1980-1988



Source: Statistics Canada and Wharton Econometric Forecasting Associates.

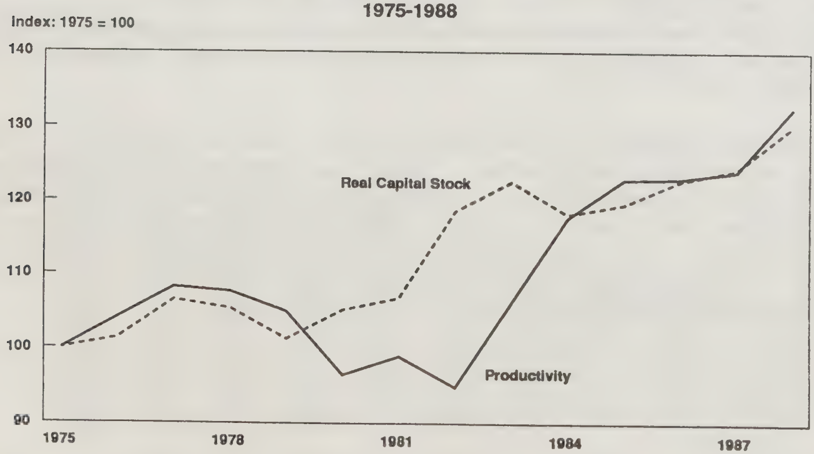
MANUFACTURING INVESTMENT
1980-1988



Source: Statistics Canada and U.S. Department of Commerce.

While labour productivity depends on many factors, including skills and technical innovation, productivity improvement is closely linked to increased capital investment. Between 1975 and 1988, the real capital stock per worker in Ontario manufacturing rose 29 per cent, closely tracking the 31 per cent increase in labour productivity.

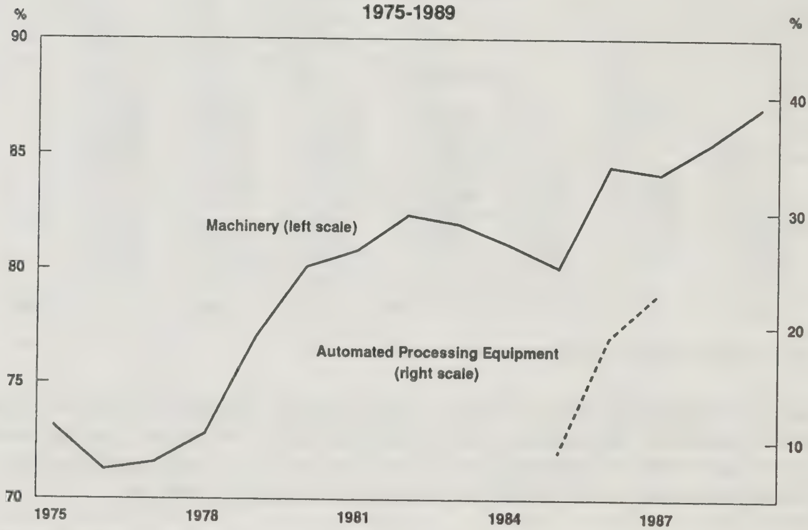
PRODUCTIVITY AND CAPITAL EMPLOYED PER WORKER
ONTARIO MANUFACTURING
1975-1988



Source: Statistics Canada and Data Resources, Inc.

During the past few years, capital investment in manufacturing has been shifting from construction to machinery and equipment: the latter now makes up 85 per cent of total investment. There has been a dramatic shift within machinery and equipment investment towards high-technology equipment such as numerically-controlled machine tools, computer-assisted design, and computer-assisted manufacturing systems.

MACHINERY AS A SHARE OF CAPITAL EXPENDITURES IN MANUFACTURING 1975-1989

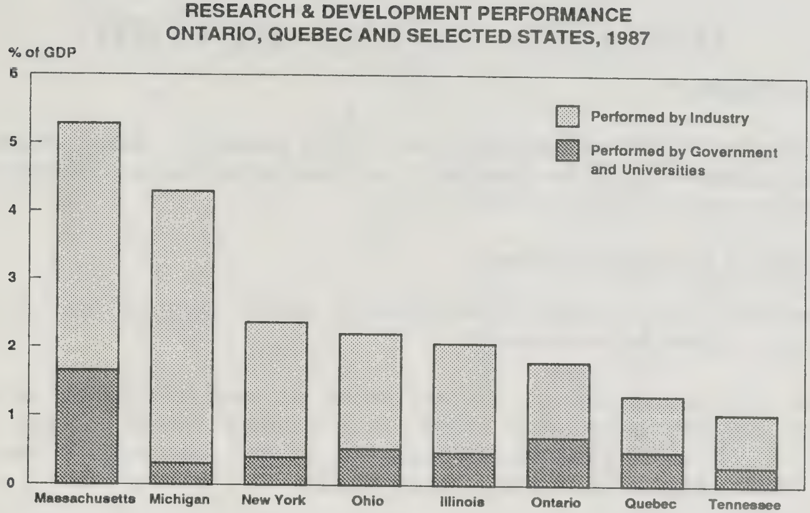


Source: Statistics Canada.

Industrial R and D Effort

Although Ontario leads Canada in research and development performance, it lags when compared to most competing states. This is true both for R and D performed by industry and for total R and D.

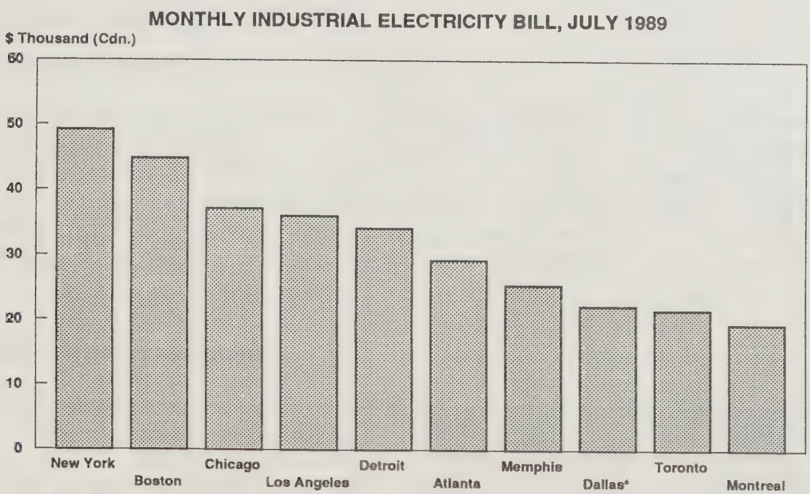
The technological position of Ontario firms is stronger than an examination of aggregate R and D statistics alone might suggest. Some Canadian-owned firms approach or even exceed the R and D efforts of their competitors in the United States. Foreign-owned firms generally perform less R and D in Canada than either Canadian-owned firms or firms in the United States in the same industry, but their competitiveness is strengthened by technology transfer from their parent corporations and other international affiliates. In some cases, however, technology is transferred only with a lag.



Source: Statistics Canada, U.S. National Science Foundation, U.S. Department of Commerce and Ontario Ministry of Treasury and Economics.

Energy Costs

Ontario industry has enjoyed a competitive advantage in its overall energy costs compared to the United States. With the deregulation of oil and natural gas markets, prices of these commodities vary little among neighbouring jurisdictions. Electricity continues to be a source of cost-competitiveness for Ontario.



* March 1989.

Note: Relevant exchange rate is $1 Cdn. = $0.85 U.S.
Based on industrial user with 400,000 kWh consumption and peak demand of 1,000 kW.

Source: Ontario Hydro and the Tennessee Valley Authority.

ONTARIO FISCAL REVIEW

Revenue Profile*

As of September 30, 1989, it is estimated that 1989-90 Provincial revenues will amount to over $40.7 billion. This section provides a brief overview of Ontario's revenue structure and describes some key characteristics.

Composition of Provincial Revenues

The Province's revenue sources include taxation, transfer payments from the federal government and other budgetary revenue.

The three major taxation sources -- personal income tax, retail sales tax and corporations tax -- will contribute approximately 64 per cent of estimated 1989-90 budgetary revenue. Taxation of gasoline and diesel fuels will contribute a further 4 per cent. In total, 74 per cent of 1989-90 revenue will be raised through taxation.

Transfer payments from the federal government will account for 13 per cent of 1989-90 revenue, a decline from 19 per cent of revenues in 1979-80.

Other revenue sources include fees and licences, LCBO profits, interest on investments and lottery profit revenue. These sources will contribute 13 per cent of this year's revenue.

The following chart shows the Ontario budgetary revenue structure.

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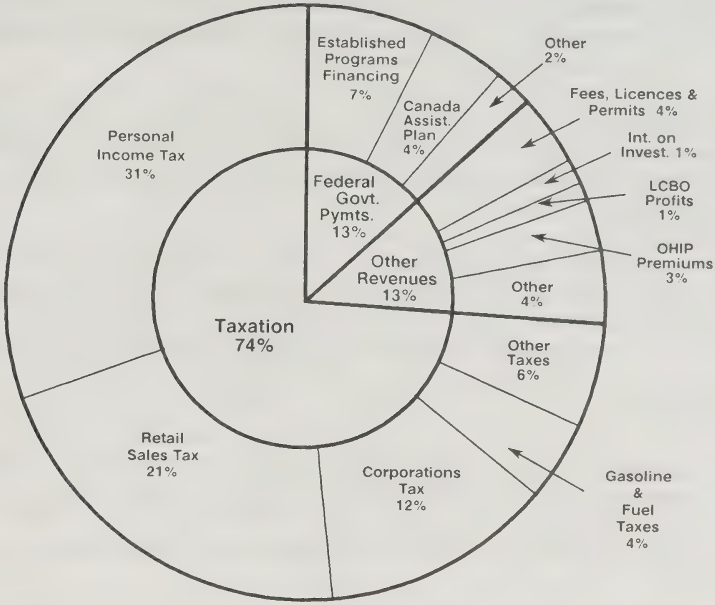
* All Ontario revenue figures for 1989-90 are based on the September 30, 1989 Ontario Finances.

COMPOSITION OF ONTARIO BUDGETARY REVENUES
1989-1990*



* Forecast as of September 30, 1989.
Source: Ontario Ministry of Treasury and Economics.

Recent Developments in Revenue Policy

Canadian Tax Reform

The federal government has announced its intention to proceed with the implementation of a new federal sales tax. The new federal Goods and Services Tax (GST) is scheduled to take effect on January 1, 1991 as outlined in a technical paper released August 8, 1989. The federal proposal has significant implications for Ontario's economy, social programs and fiscal position. The federal proposal is still under review and Ontario feels it is important that the federal government consult with the provinces as the details become finalized.

Health Care Financing Reform

The fundamental principle of Ontario's health care system is to provide all Ontarians with universal access to quality health care. In 1989-90, Ministry of Health expenditures will total $13.9 billion, an increase of 10.7 per cent over 1988-89. As a share of total Provincial spending, the Ministry of Health accounts for 33 per cent, up from 28 per cent a decade ago.

As will be indicated in the Expenditure Profile section on health care, health care expenditures have increased at an average annual rate of 12.5 per cent from 1979-80 to 1989-90. Over the same period, revenues from Ontario Health Insurance Premiums (OHIP) have increased at an average annual rate of 5.6 per cent.

In 1984-85, OHIP premiums funded 19 per cent of total health care costs. For this fiscal year, OHIP premiums would have represented 13 per cent of health care expenditures. If no action had been taken, OHIP premium revenue would have continued to decline as a percentage of total health care costs.

At the same time, the federal government has reduced its support for health care under Established Programs Financing. Contributions have declined by a total of approximately $3 billion over the past three years. The steady decline of OHIP premiums as a share of health care costs, in combination with federal government retrenchment in the funding of health care, has placed an increased pressure on the Province to fund health care programs from other revenue sources.

OHIP premiums, despite several steps taken in recent years to broaden the scope of premium assistance, impose an unfair burden on lower income groups. The Social Assistance Review Committee recommended that OHIP premiums be abolished, as this would greatly improve access to health care, particularly preventive health care, for many low-income people.

This need was recognized by the Government in 1985 when a commitment was made to eliminate OHIP premiums. In keeping with the 1985 promise, the 1989 Ontario Budget announced that, effective January 1, 1990, OHIP premium payments will be eliminated and replaced by revenue from the new Employer Health Tax (EHT).

The elimination of OHIP premiums represents a $1 billion benefit to individuals and families in 1990. Those who pay premiums directly and those who pay all or a portion of premiums through group plans will realize $550 million in premium savings. Those with employer-paid premiums will realize $450 million in personal income tax reductions, as employer-paid premiums are a taxable benefit subject to personal income tax.

Historically, the funding for health care has been shared by people and employers. Each realizes benefits from Ontario's quality health care system. To maintain balance in the funding of health care, Ontario's personal income tax rate will be increased by one percentage point, beginning January 1, 1990. Relative to premiums, use of the personal income tax system represents a more progressive method of funding Ontario's health care system.

To assist low-income groups, an additional 50,000 people will benefit from an enrichment to the Ontario Tax Reduction program. In total, 365,000 low-income individuals liable for basic federal income tax will be exempt from Ontario personal income tax and another 195,000 will benefit from reduced Ontario personal income tax.

The EHT will ensure that all employers contribute to the funding of health care. This is a more reasonable approach than the current patchwork that has many employers paying all premiums for their employees and others contributing nothing at all.

The EHT will be applied to employers' total Ontario remuneration, which includes gross wages and salaries, bonuses, commissions and taxable benefits. The general EHT rate will be 1.95 per cent of the employer's Ontario payroll. In recognition of their unique circumstance, small employers with annual payrolls not exceeding $200,000 will be eligible for a special half-rate of 0.98 per cent. Employers with annual payrolls from $200,001 to $400,000 will be eligible for graduated rates between 0.98 per cent and 1.95 per cent. Employers with annual payrolls not exceeding $400,000 will be eligible to remit EHT payments quarterly instead of monthly. The option of quarterly remittances will be available to about 85 per cent of employers in Ontario, and will provide them with greater cash flow flexibility and reduced administration and compliance costs.

Employers with annual payrolls exceeding $400,000 will be required to remit their first instalment in January 1990, based either on the payroll of the previous month or estimated January payroll. Employers with annual payrolls not exceeding $400,000 will be able to remit their first payment in April 1990 for the payroll of the previous three months.

The EHT is estimated to fund about 16 per cent of total health care costs and will generate about $2.1 billion in net revenue for health care on a full-year basis.

The EHT is estimated to increase the net costs for business by about $553 million on a full-year basis. Employers paying OHIP premiums on behalf of their employees will benefit from the elimination of premiums. Employers subject to income tax will be able to reduce their income tax, as EHT will be deductible for income tax purposes.

The combination of OHIP premiums and EHT revenue will yield an estimated $1,790 million to the Province in 1989-90. This represents an increase of only 2.6 per cent over last year's OHIP premiums, which provided $1,745 million.

Transportation Capital Financing Plan

The 1989 Ontario Budget introduced a number of measures to provide for the new Transportation Capital Program, which will provide $2 billion over five years to improve and expand the existing transportation network.

The Commercial Concentration Tax (CCT), which will be effective as of January 1, 1990, imposes a tax of $1 per square foot on office buildings, shopping centres, freestanding retail outlets and hotels in the Greater Toronto Area that have gross areas in excess of 200,000 square feet. The first 200,000 square feet of these structures will be exempt. In addition, the CCT will be levied on the total square footage of all commercial paid public parking lots and garages, regardless of size.

The rate of tax on gasoline and diesel fuel was increased by one cent per litre. The tax on gasoline will increase an additional one cent per litre on January 1, 1990.

Passenger motor vehicle registration fees were increased from $54 to $66 in Southern Ontario and from $27 to $33 in Northern Ontario. Fees were increased a further $24, to a total of $90, for residents of the Greater Toronto Area.

Environmental Initiatives

The 1989 Ontario Budget introduced a number of new initiatives to help support the Government's environmental programs. The Budget provided a 16.4 per cent increase in funding for the Ministry of The Environment over the previous year.

A tax of $5 was imposed on the purchase of each new pneumatic tire, including each new tire purchased as part of a vehicle. Very small tires, such as bicycle tires and those used for home and garden equipment (e.g., tires for wheelbarrows, lawn mowers and roto-tillers) are exempt.

A tax was also imposed on the purchase of new fuel-inefficient passenger cars -- those with highway fuel consumption ratings of 9.5 litres per 100 kilometres or greater. The tax increases as a car's fuel efficiency decreases. Tax levels of $600, $1,200, $2,200 and $3,500 apply to four classes of fuel-inefficient cars.

A disposal charge of five cents, including 12 per cent Retail Sales Tax, will be applied on all beverage alcohol containers for which there is no deposit or recycling system.

The 1989 Budget applied the Retail Sales Tax to pesticides and fertilizers. Purchases by farmers are still exempt.

In order to promote environmentally safe production processes, the Current Cost Adjustment under the corporate income tax was expanded to include air and water pollution control equipment.

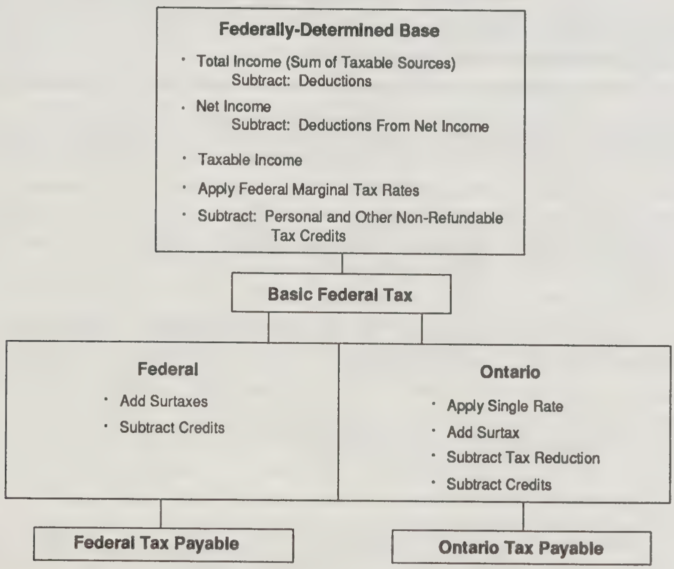
Description of the Major Taxation Sources

Personal Income Tax

Under the terms of the Tax Collection Agreement between the Government of Canada and the Government of Ontario, the federal government collects and administers the Ontario Personal Income Tax on behalf of the Province. The federal government determines the tax base by establishing the definition of taxable income. Basic Federal Tax is calculated by applying the federal marginal tax rate structure to the taxable income base and deducting specified non-refundable credits. Federal tax payable is then determined by applying federal surtaxes and deducting federal credits.

The diagram below illustrates the calculation of federal and Ontario personal income tax payable.

THE PERSONAL INCOME TAX SYSTEM



The federal marginal tax rates for 1989, including both the general federal surtax and the high-income federal surtax, range from 17.68 per cent on taxable income in the lowest tax bracket to 30.60 per cent on taxable income in the highest tax bracket.

Basic Ontario Income Tax is defined as a percentage of Basic Federal Tax. For 1989, based on a statutory rate of 52 per cent of Basic Federal Tax, Ontario's personal income tax rates on taxable income range from 8.84 per cent to 15.08 per cent. The statutory rate will be increased to 53 per cent in 1990. The Provincial tax rate structure for 1989 is shown in Table 1. In addition, a surtax of 10 per cent is applied to Basic Ontario Income Tax in excess of $10,000. The Ontario surtax increases the top Ontario marginal tax rate

to 16.59 per cent, and in conjunction with the high-income federal surtax yields a top combined federal and Ontario marginal tax rate of 47.18 per cent. At the other end of the income scale, the Ontario Tax Reduction program eliminates Ontario income tax payable of $150 or less, for low-income taxpayers. Ontario income tax accounts for roughly one-third of an individual's total income tax.

Federal and Ontario Marginal Personal Income Tax Rates, 1989 **Table 1**

Taxable Income $	Basic Federal Rate %	Federal PIT Rate* %	Ontario PIT Rate** %	Combined Federal/Ontario PIT Rates %
Up to 27,803	17.0	17.68	**8.84**	26.52
27,804 - 55,605	26.0	27.04	**13.52**	40.56
Over 55,605	29.0	30.16	**15.08**	45.24

* Includes the general federal surtax only.
** Does not include the Ontario Tax Reduction or the Ontario surtax.

With a few exceptions, such as social assistance payments and lottery winnings, all sources of personal income are subject to tax. Deductions and non-refundable tax credits are provided for certain personal and income-earning expenses. Provisions in the personal income tax system also support investment and saving for retirement, as illustrated in the section on tax expenditures.* Appendix I highlights the major tax expenditures for these and other activities.

The Province provides special programs to relieve tax burdens on low-income Ontarians. Under the Ontario Tax Reduction program, 330,000 low-income taxfilers will pay no Ontario income tax this year. There is no comparable federal tax reduction for low-income taxpayers. In addition, Ontario provides refundable property and sales tax credits through the Ontario Tax Credit (OTC) program.

Corporations Taxes

The Province of Ontario levies the following taxes specifically on the corporate sector: Corporations Income Tax, Capital Tax and Insurance Premiums Tax. Mining companies are also subject to the Mining Tax. In addition, upon legislative approval, the Employer Health Tax (EHT) and Commercial Concentration Tax (CCT) will be levied in 1990.

The largest source of corporations tax revenue is the corporate income tax. Ontario sets its own corporate income tax base and rate structure for corporations located in the province. Alberta and Quebec also administer their own corporate income tax. All other provinces

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* Tax expenditures are specific incentives in the tax structure that reduce the normal amount of tax paid to a lower or zero amount. The value of a tax expenditure is calculated as the revenue foregone.

have entered into corporate Tax Collection Agreements with the federal government. Tax is imposed on gross corporate revenues earned in the taxation year less allowable expenses. Various corporate activities and investments receive special treatment through lower rates or accelerated deductions. The estimated cost of these measures is listed in Appendix I.

The 1989 general corporate income tax rate is 15.5 per cent of taxable income. Income from manufacturing and processing operations, mining, logging, farming and fishing is taxed at the rate of 14.5 per cent. The 1989 small business tax rate in Ontario is 10.0 per cent.

All corporations in Ontario, with the exception of insurance companies, are required to pay capital tax based on their paid-up capital. Small corporations with taxable capital under $2 million either qualify for an exemption or pay tax at reduced rates. All larger corporations must pay tax on capital employed, regardless of income tax paid. The capital tax ensures that a minimum amount of corporations tax is paid by all large Ontario corporations. Insurance companies pay insurance premium tax based on the amount of insurance premiums received in respect of Ontario policies. The recently announced Ontario Motorist Protection Plan will eliminate the insurance premium tax currently imposed on insurers for personal-use automobile premiums written in Ontario. Implementation of the Plan is scheduled for 1990. Capital taxes and insurance premium taxes are deductible expenses for federal and Ontario corporate income tax purposes.

Retail Sales Tax

The Retail Sales Tax is payable on the sale of most goods and on certain services. The tax is calculated as a specific percentage of the retail price to the consumer. The general Retail Sales Tax rate is 8 per cent. Three other rates apply to specific goods and services: 5 per cent on transient accommodation; 10 per cent on admission fees over $4 and beverage alcohol products sold at licensed establishments; and 12 per cent on beverage alcohol products sold at retail outlets.

A number of goods are specifically exempt from the Retail Sales Tax. Exempt items include: groceries; energy used for heating, cooking and lighting; children's clothing; footwear costing $30 or less; prescription drugs; specified reading material; and production machinery and equipment. Most services are excluded from the Retail Sales Tax base. The major Retail Sales Tax expenditures are listed in Appendix I.

The Province determines both the Retail Sales Tax base and rates. Registered vendors collect the tax as agents of the Province and remit it to the Government.

Motive Fuel Taxes

Ontario levies tax on motive fuels purchased in Ontario under the authority of two Acts: the *Gasoline Tax Act* and the *Fuel Tax Act (1981)*. Certain non-conventional fuels such as natural gas, alcohol (used alone or blended with another fuel) and other manufactured gases are exempt. As well, fuels used for heating and cooking and for off-road use in farming, commercial fishing and for industrial, commercial and institutional purchases qualify for exemption or full rebate of tax. Fuel taxes are levied on a per litre basis.

The Provincial tax on unleaded gasoline is 10.3 cents per litre and on leaded gasoline is 13.3 cents per litre. On January 1, 1990 these rates will increase by one cent per litre, to 11.3 cents per litre for unleaded gasoline and 14.3 cents per litre for leaded gasoline. It should be noted that sales of leaded gasoline will end on December 1, 1990.

Propane used to power licensed motor vehicles is subject to a tax of 2.3 cents per litre, increasing to 4.3 cents per litre on January 1, 1990.

All aviation fuels purchased in Ontario are subject to a tax of 2.1 cents per litre.

Diesel fuel purchased in Ontario for use in licensed on-road motor vehicles is subject to a tax of 10.9 cents per litre. A system of colouration is in place to distinguish diesel fuel sold for exempt purposes, such as farming.

A tax of 3.4 cents per litre is applied to diesel fuel used to power railroad locomotives. This tax is based on fuel use in Ontario and is allocated by applying the ratio of Ontario distance travelled to total distance travelled against total fuel purchased.

Per Point Yields

Table 2 shows the 1989-90 estimated average revenue yield of selected taxes on a per point basis. The estimated yields are based on a full year's revenue and in each case the tax points relate to a specific base and unit of tax, such as percentage point of tax or per litre of gasoline. For example, one percentage point of the Retail Sales Tax at the general rate is estimated to yield approximately $1 billion.

Estimated Average Per Point Yield, 1989-90 Full-Year **Table 2**
($ Million)

Retail Sales Tax (RST)		
8% - General	999	per percentage point
5% - Transient Accommodation	14	per percentage point
10% - Alcohol (Licensed Establishments) and Admission Fees	19	per percentage point
12% - Alcohol (Retail Outlets)	32	per percentage point
All RST rates	**1,064**	**per percentage point**
Personal Income Tax (PIT) -52% of Basic Federal Tax	238	per percentage point
Ontario (PIT) Surtax	12	per percentage point
Corporate Income Tax (CIT)		
15.5% - General	114	per percentage point
14.5% - Manufacturing and Processing, Mining, Fishing, Logging and Farming	88	per percentage point
10% - Small Business	79	per percentage point
All CIT rates	**281**	**per percentage point**
Capital Tax	126	per 1/10 point
Tobacco Tax (Cigarettes)	79	10¢ per pack of 20
Motive Fuel Taxes		
Gasoline and Aviation Fuel	153	1¢ per litre
Road and Rail Diesel	37	1¢ per litre
All Fuel tax rates	**190**	**1¢ per litre**
Employer Health Tax (0.98-1.95%)	128	per 1/10 point
Land Transfer Tax (LTT)		
0.5 % on first $55,000	21	per 1/10 point
1.0% between $55,000 and $250,000	44	per 1/10 point
1.5% over $250,000	13	per 1/10 point
2.0% above $400,000, Single Family Dwellings Only	1	per 1/10 point
All LTT rates	**79**	**per 1/10 point**

Note: See text for interpretation of these data.
Source: Ontario Ministry of Treasury and Economics.

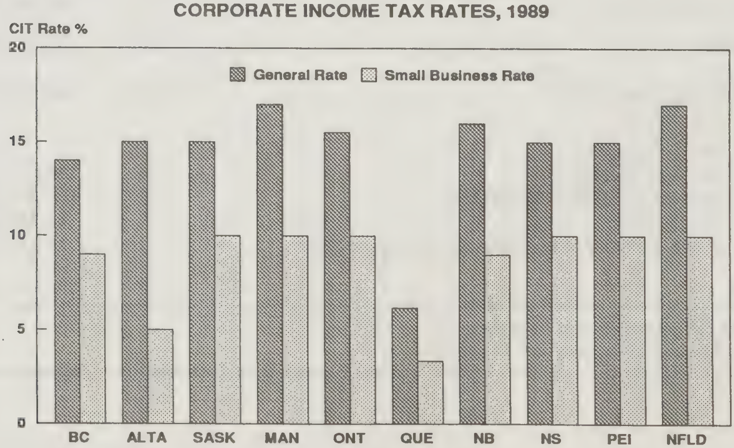
Interprovincial Tax Rate Comparisons

Interprovincial tax rate comparisons must be viewed with caution. Differences in taxable bases are particularly important in interprovincial comparisons and are best illustrated by comparing the application of the Retail Sales Tax. Significant interprovincial differences in Retail Sales Tax exemptions exist for clothing, footwear, prepared food products, heating fuels and electricity, and transient accommodation. Interprovincial differences also exist in the corporate income tax treatment of various activities. For example, as an incentive for research and development, Ontario provides an extra deduction called the Super Allowance while Quebec provides tax credits. In the personal income tax area, some provinces apply tax reductions, credits, flat taxes, or surtaxes which affect both marginal and effective tax rates.

Corporations Income Tax

As illustrated in the following chart, Ontario's general and small business Corporations Income Tax rates are comparable with those in most Canadian provinces. Corporations Income Tax is only one element of the composite Ontario corporate tax burden. Capital taxes, sales taxes, health taxes and social and employment security taxes must also be taken into account when comparing corporate tax burdens between jurisdictions. While Quebec has a lower rate of corporate income tax, the lower rates of capital tax and health tax in Ontario help to balance the corporate tax burden. For example, Quebec's general capital tax rate is 0.5 per cent as compared to 0.3 per cent for Ontario. Also, Ontario's general Employer Health Tax rate is 1.95 per cent of payroll. The payroll tax which is levied in Quebec with respect to health care is 3.36 per cent.

INTERPROVINCIAL TAX COMPARISON
CORPORATE INCOME TAX RATES, 1989

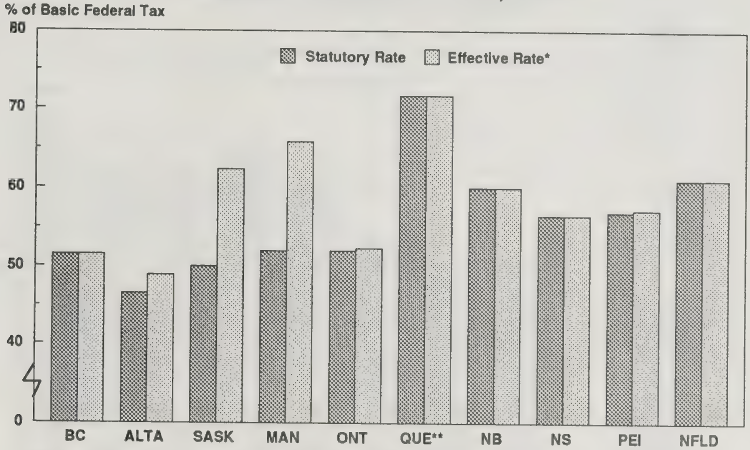


Source: Ontario Ministry of Treasury and Economics.

Personal Income Tax

Provincial Personal Income Tax rates and provincial Personal Income Tax revenues as a percentage of Basic Federal Tax are illustrated below. For 1989, Ontario's effective rate is 52.3 per cent when the Ontario Tax Reduction program and surtax are taken into account.

INTERPROVINCIAL TAX COMPARISON
PERSONAL INCOME TAX RATES, 1989



* Effective rate is total provincial income tax revenue (including any surtaxes and flat taxes, less any tax reductions) as a percentage of Basic Federal Tax assessed in the province.
** Estimated rate: Quebec does not impose tax as a percentage of Basic Federal Tax.
Source: Ontario Ministry of Treasury and Economics.

Table 3 shows the provincial and combined federal-provincial top marginal Personal Income Tax rates for 1989. Ontario has the fourth-lowest top marginal tax rate.

Top Marginal Personal Income Tax Rates*, 1989 **Table 3**
(Per Cent)

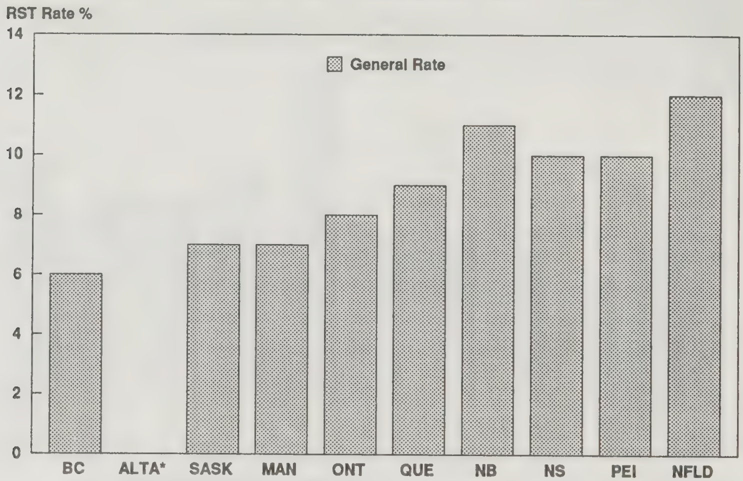
	B.C.	Alta.	Sask.	Man.	Ontario	Quebec	N.B.	N.S.	P.E.I.	Nfld.
Provincial	14.9	15.1	18.5	19.1	16.6	24.0	17.4	16.4	18.2	17.7
Combined Federal-Provincial	45.5	45.7	49.1	49.7	47.2	49.8	48.0	47.0	48.8	48.3
Rank	1	2	8	9	4	10	5	3	7	6

* Includes federal and provincial surtaxes.
Source: Ontario Ministry of Treasury and Economics.

Retail Sales Tax

General Retail Sales Tax rates in Canada range from zero per cent in Alberta to 12 per cent in Newfoundland. Ontario's rate of 8 per cent is in the mid-range of rates applied by all taxing jurisdictions.

INTERPROVINCIAL TAX COMPARISON
RETAIL SALES TAX RATES, 1989



* No provincial sales tax is imposed.
Source: Ontario Ministry of Treasury and Economics and provincial tax statutes.

Tax Expenditures

Tax expenditures are taxes that governments choose not to collect in order to redistribute income more fairly, or to encourage individuals and corporations to undertake desired activities. Tax expenditures are exceptions to the normal tax rules and are often used as alternatives to direct spending to achieve particular policy objectives.

There are four types of tax expenditures: exemptions, deductions and allowances, credits, and special reduced rates of tax. Ontario's tax system incorporates all four.

Table 4 lists the ten largest tax expenditures within Ontario's sole jurisdiction, along with an estimate of foregone revenue for each expenditure in 1989-90. Because many of these tax expenditures are interdependent, these estimates cannot be added to derive a total value of foregone revenue. A more complete list of Ontario's major tax expenditures, along with a brief description of each, is contained in Appendix I.

In addition, estimates of the impact of tax changes on Ontario's tax expenditures are provided in the annual Ontario Budget.

Ten Largest Tax Expenditures
Within Ontario's Sole Jurisdiction in 1989-90
($ Million)

Table 4

	Ontario Revenue Foregone
Retail Sales Tax Expenditures	
Professional Services	3,981
Commercial Services	2,189
Energy Goods (including motive fuels)	1,836
Personal Services	1,831
Basic Groceries	1,200
Production Machinery Goods	909
Personal Income Tax Expenditures	
Ontario Health Insurance Plan Premium Assistance*	595
Ontario Tax Grants to Seniors*	505
Ontario Property and Sales Tax Credits	444
Corporate Income Tax Expenditures	
Small Business Deduction	435

* Although not directly part of the Personal Income Tax system, these tax expenditures provide benefits to individuals. OHIP premium payments and assistance end December 31, 1989.

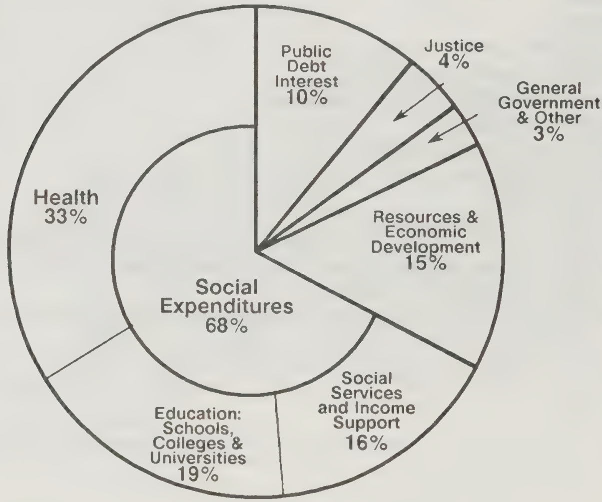
Source: Ontario Ministry of Treasury and Economics.

Expenditure Profile

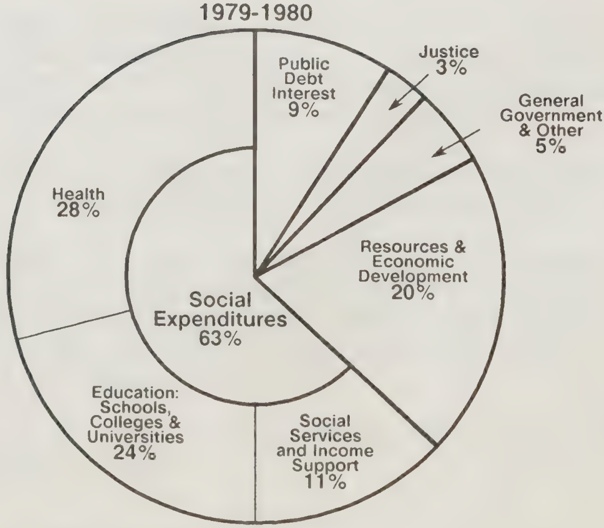
As of September 30, 1989, it is estimated that 1989-90 Provincial expenditures will amount to $41.3 billion. More than two-thirds of all Provincial spending is on social programs, with the balance allocated to resources and economic development, justice, public debt interest, and other government activities. The charts below illustrate the proportion of government spending by major expenditure area in 1989-90 and 1979-80.

DISTRIBUTION OF ONTARIO'S EXPENDITURES

1989-1990



1979-1980



Source: Ontario Ministry of Treasury and Economics .

The charts indicate that there has been an appreciable shift in the composition of Provincial expenditures. The dominant feature of this shifting pattern is a notable increase in the share of spending allocated to health care. The Ministry of Health is expected to account for 33 per cent of expenditures in 1989-90, compared to 28 per cent in 1979-80.

The proportion of Provincial spending allocated to social services and income support has also increased significantly. This area represented 11 per cent of spending in 1979-80, and accounts for 16 per cent of expenditures in 1989-90.

The increasing share of expenditures taken up by health and social services and income support has reduced the share available for education and for resources and economic development. Education expenditures represented 24 per cent of Provincial spending in 1979-80, and are estimated at 19 per cent in 1989-90. The share of Provincial spending dedicated to resources and economic development has fallen from 20 per cent in 1979-80 to an estimated 15 per cent in 1989-90.

The increasing share of spending dedicated to health care and social services and income support is of particular fiscal importance, as these programs influence the resources available for all other Provincial programs, now and in the future.

Health Care

In the period from 1979-80 to 1989-90, health care expenditures increased at an average annual rate of 12.5 per cent. After allowing for population growth, which averaged 1.2 per cent per annum over the period, per capita health care spending increased at an average rate of 11.2 per cent per year.

The largest components of Ministry of Health expenditures are the Operation of Hospitals, the Ontario Health Insurance Plan (OHIP) and the Ontario Drug Benefit Plan (ODB). In 1989-90, these three programs will account for almost 80 per cent of Ministry of Health expenditures.

Expenditures for the Operation of Hospitals, the largest component of health care expenditures, increased at an average annual rate of 11 per cent over the 1979-80 to 1989-90 period. Spending during this period has almost tripled from $2.1 billion to $6.0 billion. However, the share of the Ministry of Health budget dedicated to the Operation of Hospitals has declined from 50 per cent in 1979-80 to 43 per cent in 1989-90.

OHIP costs have increased at an average annual rate of 14.4 per cent over the period, almost quadrupling total OHIP outlays from $1.1 billion in 1979-80 to $4.3 billion in 1989-90, and increasing the program's share of Ministry of Health expenditures from 26 per cent to 31 per cent. Greater utilization and an average annual 3.6 per cent increase in the number of physicians over the past ten years have contributed to this increase.

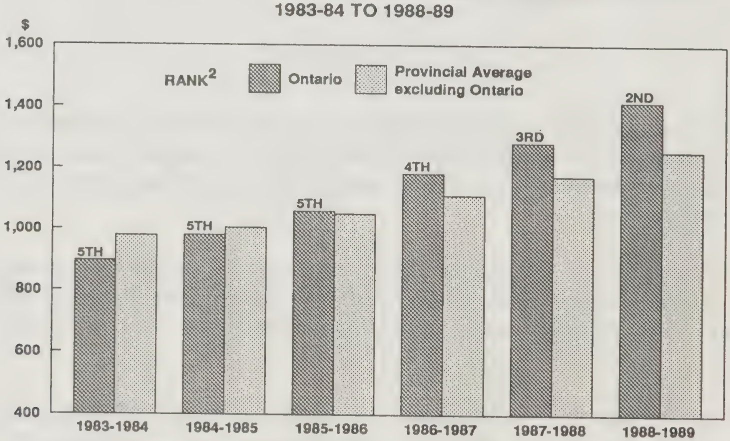
One of the most rapidly growing components of health care costs is the Ontario Drug Benefit Plan. Ministry of Health expenditures on the ODB Plan increased from $107 million in 1979-80 to $659 million in 1989-90. The share of Ministry of Health expenditures allocated

to ODB increased from 2.5 per cent to 4.7 per cent over the period. One factor accounting for this fast growth has been a rapid increase in the size of the eligible population. There are 36 per cent more seniors aged 65 and over in the province in 1989 compared to 1979.

The rapid growth of health care expenditures in Ontario has resulted in a marked increase in Ontario's per capita health care expenditures relative to per capita health care spending in the other provinces. The following chart shows per capita health spending in Ontario compared to the average health care spending in the other nine provinces over the 1983-84 to 1988-89 period.

In 1983-84, Ontario's per capita health care spending, at $896, was about 9 per cent below the average spending in the other provinces of $979 per capita. By 1988-89, Ontario's per capita spending level was $1,416, about 12.5 per cent above the average of $1,259 per capita spent in the other nine provinces. The higher rate of increase in Ontario compared to the other provinces has resulted in Ontario's rank in per capita health care spending increasing from fifth highest in 1983-84 to second highest in 1988-89.

PROVINCIAL HEALTH CARE SPENDING[1] PER CAPITA
1983-84 TO 1988-89



1 Combined Provincial and local government sectors.
2 Ontario's rank among provinces, from highest to lowest.
Source: Statistics Canada.

Social Services and Income Support

The increasing share of Provincial spending dedicated to social services and income support is largely the result of greater expenditures by the Ministry of Community and Social Services (MCSS). Between 1979-80 and 1989-90, spending by MCSS grew at an average annual rate of 14 per cent.

Between 1979-80 and 1989-90, expenditures on income support increased from $648 million to $2.5 billion, an average annual growth rate of 15 per cent. This growth is attributable to improvements in the average level of benefits provided to social assistance recipients, higher shelter costs, inflation and increases in the numbers of disabled persons and single parents receiving income support.

Programs for seniors have also grown. Operating expenditures on municipal and charitable homes for the aged grew from $120 million in 1979-80 to $360 million in 1989-90, an average annual increase of 12 per cent. Inflation and increased care requirements explain the expenditure growth. In recent years there has also been an expansion of services to help seniors maintain an independent lifestyle in their own communities. Expenditures on community-based programs such as Home Support Services, Elderly Persons Centres, Homemakers and Nurses Services, and the Integrated Homemakers Program grew from $17 million in 1984-85 to $120 million in 1989-90, an average annual growth rate of 48 per cent.

There have also been increases in funding for children's programs, such as Child Care. Between 1984-85 and 1989-90, operating expenditures on Child Care grew from $87 million to $327 million, an average annual growth rate of 30 per cent. The increases reflect expansions in the number of subsidized spaces, improvements in wages paid to child care workers and inflation.

Services provided to persons with developmental handicaps have been enhanced to provide more clients with community accommodation and support to maximize their capacity for independent living. Expenditures have grown from $429 million in 1984-85 to $704 million in 1989-90, an average annual growth rate of almost 11 per cent.

Transfer Payments

Almost three-quarters of the Government's expenditures, or $30.3 billion, are transfer payments to third parties such as hospitals, school boards, universities and municipalities. The principal transfers are listed on the following page.

1989-90 Transfer Payments **Table 5**

	$ Billion	% of Spending
Five Major Transfers		
Hospitals	6.0	14.5
Colleges	0.7	1.7
Universities	1.7	4.1
School Boards	4.2	10.2
Municipalities	4.5	10.9
Other Transfers		
OHIP	4.3	10.4
ODB*	0.8	1.9
Other	8.1	19.6
Total Transfer Payments	30.3	73.3

* Includes drug benefit plans under the Ministry of Health and the Ministry of Community and Social Services.

Source: Ontario Ministry of Treasury and Economics.

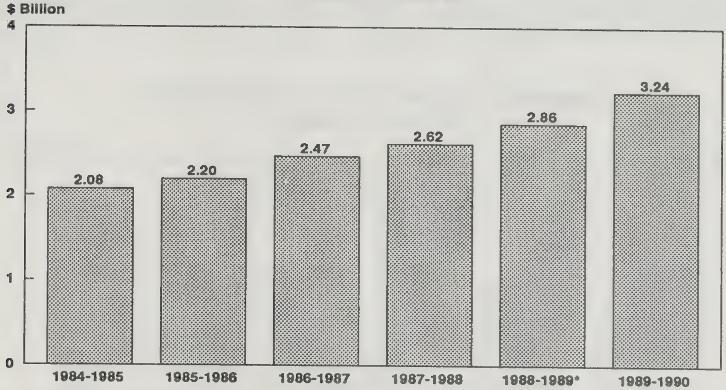
Non-Transfer Payment Expenditures

The 26.7 per cent of expenditures which are not allocated in the form of transfer payments amount to $11.0 billion. Almost $4.3 billion of non-transfer payments will fund public debt interest. The remaining $6.7 billion will fund institutions and services operated by the Province, such as psychiatric hospitals, correctional facilities, provincial parks, and other government programs, including administration and regulatory activities.

Capital

Approximately $3.2 billion is provided in 1989-90 for capital investments, including investments made by transfer payment recipients. Since 1984-85, Provincial capital expenditures have increased at an average annual rate of 9.3 per cent. The following graph shows the level of capital expenditures in recent years.

CAPITAL EXPENDITURES
1984-85 TO 1989-90



* Excludes $410 million in advance payments from 1989-90.
Source: Ontario Ministry of Treasury and Economics.

Summary of Expenditures

Expenditures are expected to grow by $2.6 billion between 1988-89 and 1989-90. The 1989-90 expenditure plan reflects the accelerated payment in 1989-90 of $410 million, which would normally have been paid in 1990-91, including $300 million for education capital and $110 million for colleges and universities capital. A further $823 million, which would have been paid this year, was accelerated and paid in 1988-89, including $300 million for education capital, $110 million for colleges and universities capital, and $413 million for municipal unconditional grants.

Spending Control

Savings and Constraints Measures

The 1988 Budget contained a provision for a Government-wide $500 million expenditure savings and constraints program. This in-year expenditure target was achieved as part of the Government's continuing effort to control spending and improve the efficiency of program delivery.

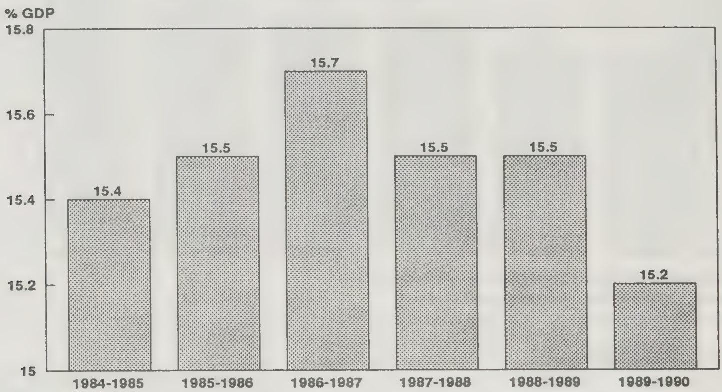
Every ministry contributed to the savings and constraints goal through across-the-board reductions in total salaries and benefits of two per cent and reductions in non-payroll expenditures of six per cent. In addition, some ministry-specific reductions were applied to general program areas based on reduced cash flow requirements.

The 1989 Budget set a target of $200 million in expenditure savings and constraints. As of September 30, 1989, $40 million has been identified. Over the period 1985-86 to 1989-90, savings and constraint measures will have generated a total of $1.1 billion in savings.

Expenditure Indicators

Since 1986-87, Provincial expenditures as a share of the economy have declined. The forecast for 1989-90 is 15.2 per cent of GDP.

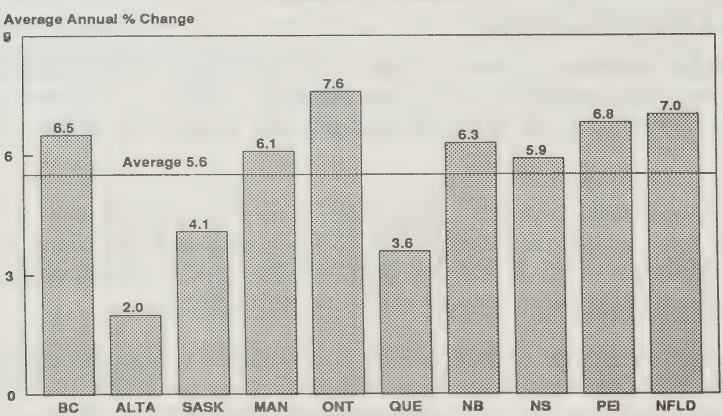
EXPENDITURES AS A SHARE OF THE ECONOMY
1984-85 TO 1989-90



Source: Ontario Ministry of Treasury and Economics.

Relative to the other provinces, Ontario has had the highest rate of growth in per capita expenditures over the past five years. From 1985-86 to 1989-90, the all-province average annual rate of per capita expenditure growth has been 5.6 per cent, compared to Ontario's average rate of 7.6 per cent.

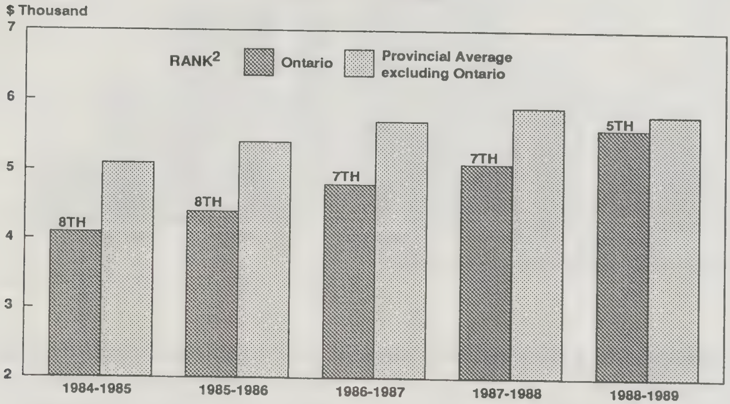
PER CAPITA SPENDING GROWTH
1985-86 TO 1989-90



Source: Ontario Ministry of Treasury and Economics.

Despite high rates of per capita expenditure growth, the level of per capita expenditures in Ontario remains below the average level of other provinces, ranking Ontario fifth among the provinces in per capita spending. However, faster expenditure growth in Ontario is narrowing this spending gap. This trend is shown in the following chart.

TOTAL PROVINCIAL EXPENDITURES [1] PER CAPITA
1984-85 TO 1988-89

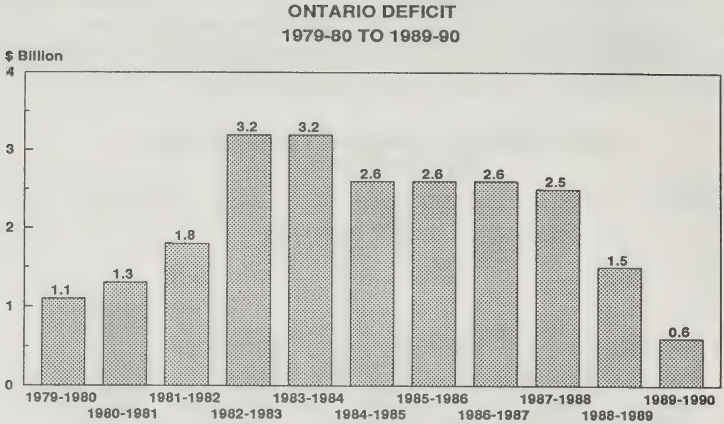


1 Combined Provincial and Local government sectors.
2 Ontario's rank among provinces, from highest to lowest.
Source: Statistics Canada.

Fiscal Indicators

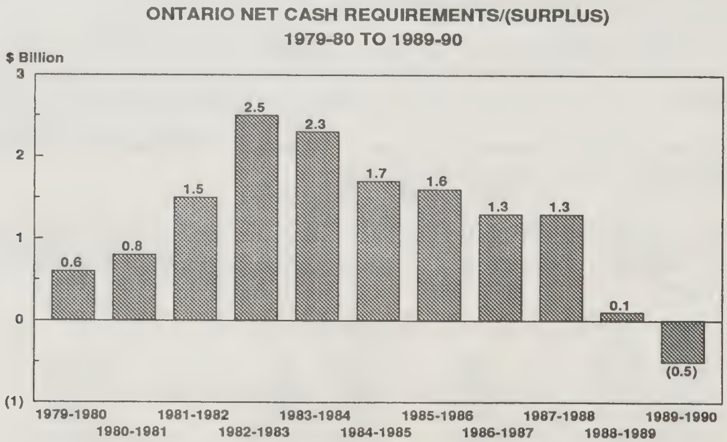
Ontario's fiscal trends can be assessed in terms of commonly used indicators. The following section evaluates the fiscal position of the Province.

Ontario's deficit rose to a level of almost $3.2 billion in 1982-83, but since that time has declined to $1.5 billion in 1988-89, and is forecast to be $0.6 billion in 1989-90, the lowest level since 1974-75.



Source: Ontario Ministry of Treasury and Economics.

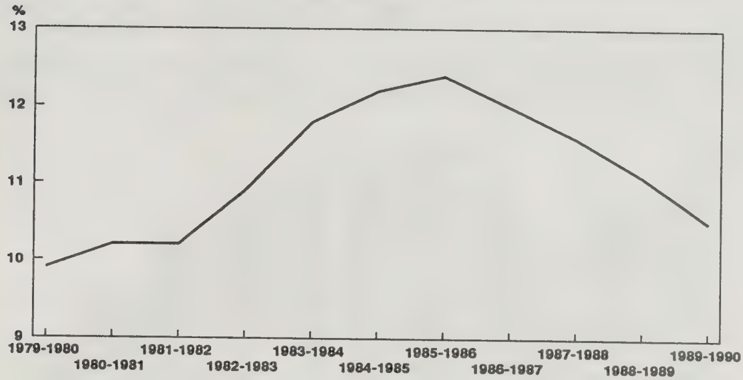
Net cash requirements have been reduced from the $2.5 billion peak level reached in 1982-83 to $50 million in 1988-89. A surplus of $477 million is estimated for 1989-90.



Source: Ontario Ministry of Treasury and Economics.

Ontario's public debt interest costs will be almost $4.3 billion in 1989-90, requiring 10.5 per cent of revenue. By contrast, federal public debt charges in 1989-90 are currently forecast at 35 per cent of federal budgetary revenues. The Ontario proportion continues its downward trend from a high of 12.4 per cent in 1985-86.

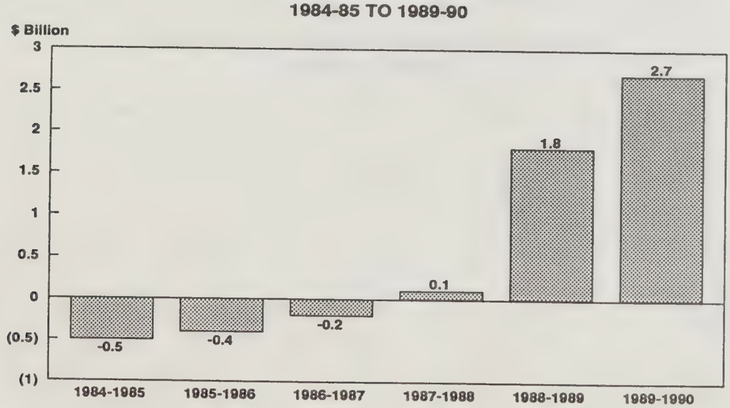
PUBLIC DEBT INTEREST AS A PERCENTAGE OF REVENUE
1979-80 TO 1989-90



Source: Ontario Ministry of Treasury and Economics.

Ontario's operating position reflects the Province's ability to pay for day-to-day operating needs from its revenue. Expenditure excludes spending on capital investments. In 1989-90, Ontario's operating position will be in surplus by almost $2.7 billion. This operating surplus will finance 82 per cent of the Province's $3.2 billion capital expenditure program.

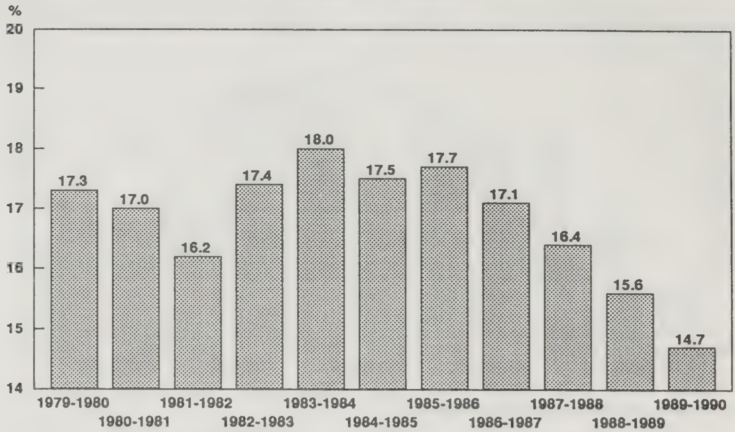
ONTARIO OPERATING POSITION
1984-85 TO 1989-90



Source: Ontario Ministry of Treasury and Economics.

Ontario's total own-purpose debt is expected to be $40.0 billion by the end of 1989-90. Measured as a share of the economy, the debt burden has moderated in the past six years. From a peak of 18.0 per cent of provincial GDP in 1983-84, the debt burden declined to 15.6 per cent in 1988-89. In 1989-90, debt as a share of the economy is expected to decline further to 14.7 per cent.

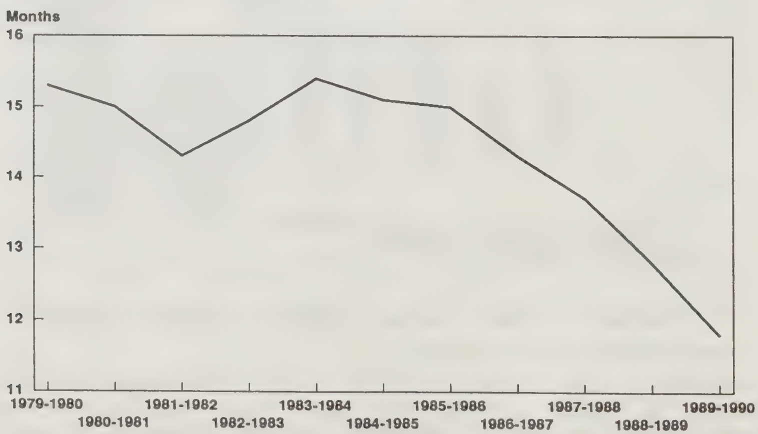
TOTAL OWN-PURPOSE DEBT AS A SHARE OF THE ECONOMY
1979-80 TO 1989-90



Source: Ontario Ministry of Treasury and Economics.

Ontario's ability to carry its total own-purpose debt can also be measured by the number of months of revenue that would be required to repay this debt. The number of months has fallen steadily in the past six years, from 15.4 months in 1983-84 to 12.6 months in 1988-89. In 1989-90, it is expected to fall further to 11.8 months.

MONTHS OF REVENUE TO REPAY TOTAL DEBT
1979-80 TO 1989-90

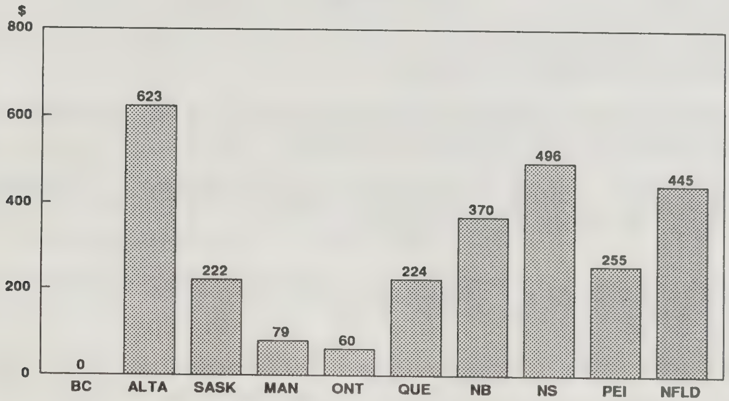


Source: Ontario Ministry of Treasury and Economics.

In addition to its total own-purpose debt, the Province's debt on behalf of Ontario Hydro was $7.8 billion as of March 31, 1989. Ontario Hydro's debt guaranteed by the Province amounted to $19.3 billion as of March 31, 1989.

On an interprovincial basis, Ontario's fiscal performance compares favourably. At $60 per person, Ontario will have the second lowest deficit per capita in 1989-90.

DEFICITS PER CAPITA
1989-1990



Source: Ontario Ministry of Treasury and Economics.

Medium Term Fiscal Outlook

This section describes a projection of the Province's fiscal outlook over the medium term. Projections of Ontario's fiscal position over the period 1990-91 to 1992-93 represent current-trend revenues and expenditures and are based on an assumption of no policy change. The trends outlined below may be altered by either unexpected changes in the economy or by future changes to Government revenue or expenditure policies. As discussed further below, the projected trends do not reflect the potential impacts of the proposed Goods and Services Tax. The imposition of such a tax would also alter the projections presented.

Factors Influencing Expenditure Growth

A number of factors cause expenditures generally to grow at a rate faster than the increase in inflation as measured by the Consumer Price Index (CPI):

- Population increases. Ontario's population has been increasing at an average annual rate of 1.5 per cent for the last five years;

- Demographic changes. For example, an aging population will require the provision of more health and other support services;

- Economic growth. Growth increases demand for Government spending in such areas as highways, housing, municipal infrastructure and recreational facilities; and

- Introduction of new programs or expansion of existing programs. New programs are usually introduced to address emerging social issues such as AIDS, environmental concerns or the need for child care.

These factors have contributed to expenditure growth over the past six years which generally exceeded inflation (CPI) rates by three to five percentage points. In periods of strong economic growth, such as those experienced by Ontario in recent years, expenditure growth in the 7-9 per cent range can be accommodated within the rate of growth of the economy. In the past three years, expenditures have grown at an average of about 1.1 percentage points below the rate of growth in GDP.

When expenditure growth rates exceed the rate of growth in the economy over a sustained period, deficit pressures increase and a build-up in public debt may occur, unless offsetting tax increases are implemented.

Factors Influencing Revenue Growth

The Government receives revenue from a number of sources including taxation, fees and licences, and transfers from the federal government. Not all revenue sources are responsive to economic growth. In fact, only 70 per cent of revenues fall into this category. As a result, revenues from responsive sources such as the Retail Sales Tax and Personal Income Tax must grow substantially faster than the rate of economic growth to maintain overall revenue growth

at rates close to the rate of economic growth. Historically, revenues have increased at approximately 90 per cent of the rate of growth in the GDP.

The 30 per cent of the revenue sources which are not responsive to economic growth are primarily fees which are adjusted at discrete intervals, or federal transfers which are not controlled by the Province. Specific government action is needed to influence the rate of increase in these revenue sources.

Fiscal Projection

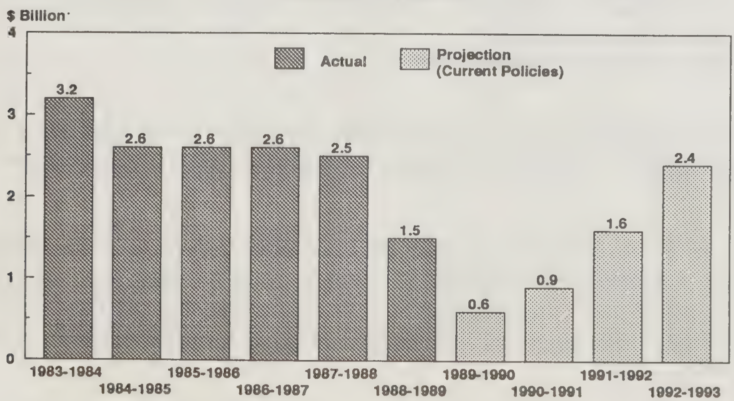
The fiscal projection brings together the trends in revenue and expenditure growth discussed above with the current forecast of economic growth.

The fiscal projection, based on the economic forecast developed by the Ministry of Treasury and Economics, assumes no change in existing revenue policy and a continuation of the 1989-90 revenue structure. Projected revenues are also assumed to grow at their historical rate of 90 per cent of GDP growth. Expenditures are assumed to grow in the future at 8.7 per cent annually, the average experienced over the past three years.

Under this current policy scenario, the deficit would grow from $0.6 billion in 1989-90 to $2.4 billion by 1992-93. As the Provincial revenue base is less than that of expenditures in absolute terms, revenues would have to grow at much faster rates than expenditures to maintain the current deficit level.

It should be emphasized that this projection is based on the assumption of no policy change over the period, and in no way reflects a fiscal target.

ONTARIO DEFICIT PROJECTION [1]
1983-84 TO 1992-93

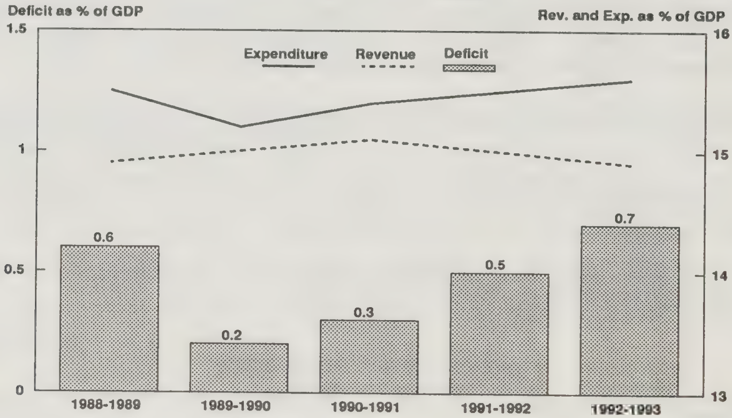


1 Does not include impact of the GST.
Source: Ontario Ministry of Treasury and Economics.

An economic downturn or a recession would have an adverse impact on the Province's finances. Revenue losses resulting from weaker economic growth combined with demands for Government to undertake countercyclical expenditure measures, such as additional funding for job creation or social assistance, could place significant upward pressure on the projected deficit levels.

Assuming that revenues continue to grow at their historical rate of 90 per cent of GDP growth over the projected period, revenues would fall as a share of the economy. Expenditures continuing to grow at 8.7 per cent in a moderating economy would result in expenditures increasing as a share of the economy. With the share of revenues falling and the share of expenditures rising, the deficit would also increase as a per cent of the economy. These trends are illustrated in the following graph.

REVENUE, EXPENDITURE AND DEFICIT AS A SHARE OF ECONOMY[1]



1 Does not include impact of the GST.
Source: Ontario Ministry of Treasury and Economics.

The projection as discussed above does not include the impact of the proposed federal Goods and Services Tax (GST). This federal proposal would affect the Province's finances in many ways.

For example, on the revenue side, the proposed one point reduction in the federal personal income tax rate, and anticipated increases in unemployment resulting from the GST over the forecast period, would result in a reduction in Personal Income Tax revenues to Ontario. The federal government is also proposing that the GST apply to provincial lottery profits, reducing revenues from that source.

The GST inflationary impact would increase the cost of delivering Provincial services. Higher unemployment can be expected to increase the cost of current programs to assist the unemployed. Some off budget expenditures, for example, indexed public sector pensions and Workers' Compensation benefits, would also be affected by an increase in the inflation rate.

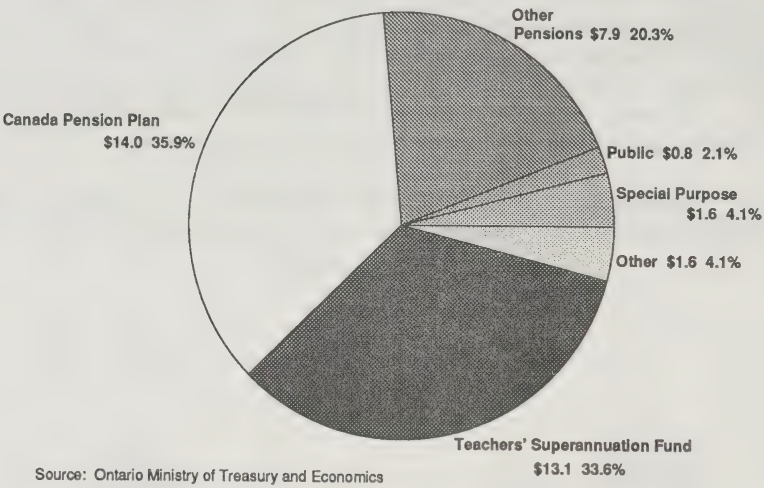
The financial position of our major transfer partners -- municipalities, universities, colleges, schools and hospitals -- would also be affected by the GST. The federal Minister of Finance has undertaken that the reform of this federal sales tax will impose no greater burden than before reform. The Province remains concerned that the federal government proposal to first levy the GST at 9 per cent on all purchases and subsequently provide partial GST rebates to these institutions will make the achievement of this commitment questionable. For example, the tax-partial rebate method will have negative cash flow consequences for these institutions.

While the exact financial impact of the proposed GST depends on a number of factors, the net effect of the tax on Ontario's fiscal position over the forecast period would be negative, and could be large.

Debt and Debt Financing*

Ontario's Debt

COMPOSITION OF ONTARIO'S OWN-PURPOSE TOTAL DEBT
MARCH 31, 1989
($ BILLION)



Source: Ontario Ministry of Treasury and Economics

Ontario's total debt, at $39.0 billion as of March 31, 1989, includes all Provincial liabilities issued for Provincial purposes. It is comprised of debentures, notes and treasury bills of $29.5 billion, pension and related benefit fund liabilities of $7.9 billion, and $1.6 billion of Special Purpose Accounts, mainly deposits with the Province of Ontario Savings Office.

Ontario's debt is concentrated in pension liabilities, with the largest proportions owed to the Canada Pension Plan (CPP) and the Teachers' Superannuation Fund (TSF). Debt owed to the general public constitutes only 2.1 per cent of the Province's total debt, while the liabilities of the Special Purpose Accounts total 4.1 per cent.

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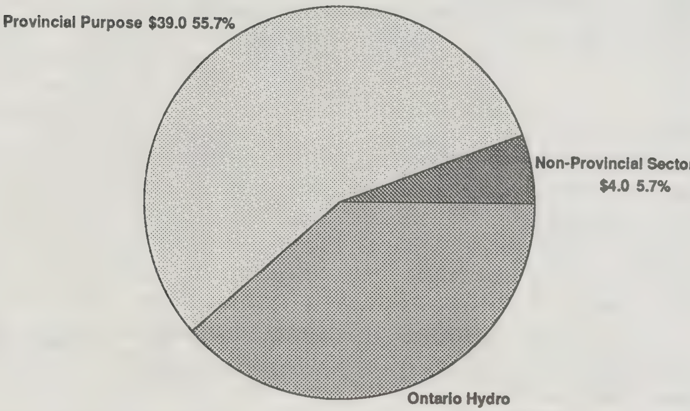
* All Ontario debt figures for 1989-90 are based on the September 30, 1989 Ontario Finances.

Consolidated Public Sector Debt

CONSOLIDATED PUBLIC SECTOR DEBT
MARCH 31, 1989
(INTERIM $ BILLION)



Source: Ontario Ministry of Treasury and Economics.

The broadest measure of debt in the Ontario Public Sector is Consolidated Public Sector Debt, which includes debt incurred at all levels of Provincial jurisdiction. As of March 31, 1989, Consolidated Public Sector Debt is estimated to have reached $70.0 billion. This debt measure has been restated to include Ontario's debt to pensions and related benefit funds and Special Purpose Accounts.

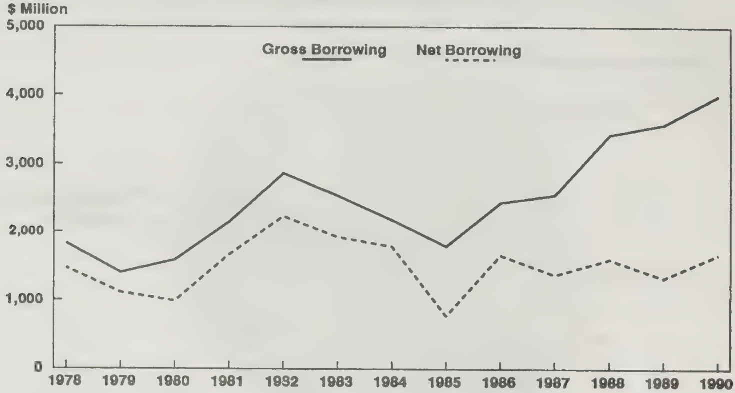
The preponderance of Provincial and Provincially-guaranteed debt in this measure illustrates Ontario's practice of centralizing public sector financing at the Provincial level. Ontario's direct and guaranteed debt, which is over 90 per cent of the consolidated debt, consists of obligations for the Province's own purpose and for Ontario Hydro. Given the prominence of Ontario's practice of centralized financing, there has been a limited requirement for public borrowing by municipalities, school boards, universities, colleges and hospitals. Internal funds and Provincial grants finance a large proportion of local capital expenditures, with the remainder financed through borrowing. Local government debt is about four per cent of consolidated debt, while less than one-half of one per cent consists of the liabilities of universities, colleges and hospitals. The Provincial share of Consolidated Public Sector Debt (direct and guaranteed) has been rising over time, reflecting the centralized approach to financing.

Hydro Borrowing

Ontario Hydro's annual gross borrowing is expected to be around $3.6 billion in 1989 and $4.0 billion in 1990, with borrowing net of retirements amounting to $1.3 billion in 1989

and $1.7 billion in 1990. The Province monitors Hydro's financing needs and ensures that they are consistent with the Province's fiscal and financing plans.

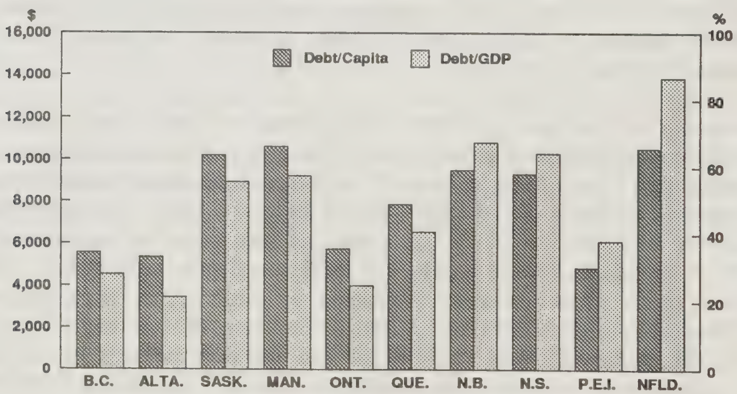
ONTARIO HYDRO BORROWING *



* 1978 to 1988 are actual figures, 1989 are interim figures and 1990 are forecasted figures.
Source: Ontario Hydro.

Interprovincial Debt Comparison

INTERPROVINCIAL DEBT COMPARISIONS
DECEMBER 1988



Source: Bank of Canada and Ontario Ministry of Treasury and Economics.

Interjurisdictional debt comparisons usually focus on direct and guaranteed debt measures because this assures a standard of conceptual uniformity and comparability across jurisdictions and over time. Nevertheless, the comparisons remain limited by exclusion of pension fund

deposits and certain other borrowings, and by differences in treatment across provinces of sinking funds and purchases by public sector investment funds, such as the Alberta Heritage Savings Trust Fund.

Ontario's direct and guaranteed debt measures are relatively low compared to other provinces. In 1988, Ontario owed $5,716 per person. This was the fourth-lowest level of direct and guaranteed debt per capita in Canada, higher only than Prince Edward Island, Alberta and British Columbia. Ontario had the second-lowest level of direct and guaranteed debt as a percentage of GDP (25.0 per cent), after Alberta.

Ontario's Financing

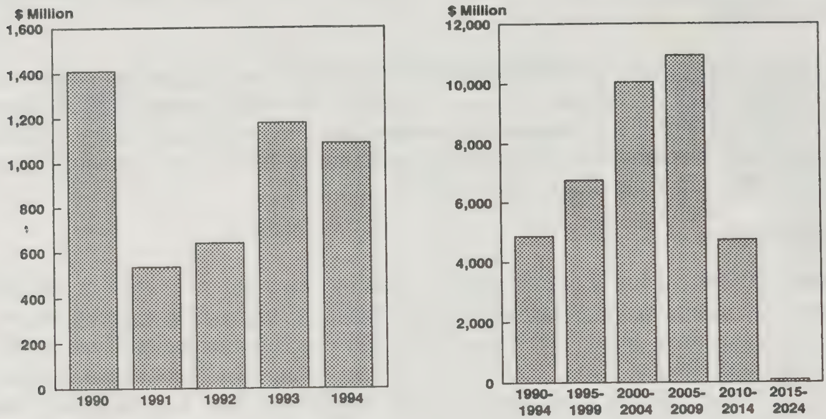
The Province of Ontario has available for its financing purposes the funds of the domestic and international capital markets, as well as the funds of the public sector pensions: the Teachers' Superannuation Fund (TSF), the Public Service Superannuation Fund (PSSF), the Superannuation Adjustment Fund (SAF), and Ontario's share of the Canada Pension Plan (CPP). Since the legislation governing the TSF, PSSF and SAF has required Ontario to borrow from these funds, they have been a growing source of financing for Ontario to date. In the past three years, availability of non-public sources of funds exceeded the Province's needs. Consequently, Ontario has declined almost all of the CPP funds available to it. CPP funds not required by the Province have been offered to Ontario Hydro. To date, in 1989-90, the Province has borrowed $651 million from the CPP on behalf of Ontario Hydro. In addition, the Province will make $3 billion of CPP funds available to aid in the provision of 30,000 units of non-profit housing over the next 3-5 years, and up to $200 million of CPP funds to Ontario school boards for capital requirements.

The Ontario Government has proposed legislation which will fundamentally change Ontario's current borrowing arrangements. Under the proposed legislation, beginning January 1, 1990, the teachers' and public service pension plans would invest their net cash flow in public capital markets. Ontario's borrowing requirements, if any, in and beyond 1990-91 are expected to be met through public borrowing.

Ontario's Maturing Debt

Approximately 13 per cent of Ontario's own-purpose debt is scheduled to mature in the five-year period from April 1990 to March 1994, and 31 per cent in the ten years from 1990 to 1999. In the five-year period ending March 1994, maturities will total $4.8 billion, with about 53 per cent representing retirements of Canada Pension Plan liabilities.

ONTARIO DEBT MATURITY



Source: Ontario Ministry of Treasury & Economics

Credit Worthiness

Provincial Ratings October 1989 — **Table 6**

	Standard and Poor's (S&P)	Moody's	Canadian Bond Rating Service (CBRS)	Dominion Bond Rating Service (DBRS)
British Columbia	AA+	Aa1	AA+	AA
Alberta	AA+	Aa1	AA	AA
Saskatchewan	AA -	A1	AA -	A (high)
Manitoba	A+	A1	AA -	A
Ontario	AAA	Aaa	AAA	AA
Quebec	AA -	Aa3	A	A (high)
New Brunswick	A+	A1	A	A
Nova Scotia	A -	A2	A -	A (low)
Prince Edward Island	NR*	A3	BBB+	A (low)
Newfoundland	A -	Baa1	BBB	BBB

* Not Rated.

Source: Ontario Ministry of Treasury and Economics, Canadian Bond Rating Service, Dominion Bond Rating Service, Moody's Bond Survey and Standard and Poor's CreditWeek.

Ontario is the only Canadian province assigned Triple A by three credit rating agencies (Standard and Poor's, Moody's and the Canadian Bond Rating Service). The Province shares Dominion Bond Rating Service's highest provincial rating (AA) with Alberta and British Columbia.

Rating Adjustments in 1988 and 1989 **Table 7**

	Rating Change	
British Columbia	Upgraded from:	AA to AA+ (S&P) Aa2 to Aa1 (Moody's) AA to AA+ (CBRS) AA(low) to AA (DBRS)
Manitoba	Upgraded from:	A(low) to A (DBRS)
Ontario	Upgraded from:	AA+ to AAA (S&P)

Source: Ontario Ministry of Treasury and Economics, Canadian Bond Rating Service, Moody's Bond Survey and Standard and Poor's CreditWeek.

Federal-Provincial Funding Programs

The following sections describe the two major programs through which the provinces now receive federal funding: Federal-Provincial fiscal arrangements and the Canada Assistance Plan.

Federal-Provincial Fiscal Arrangements

Introduction

The federal-provincial fiscal arrangements are the institutional vehicles through which the federal government transfers funds to the provinces as part of its historical commitment to certain national shared-cost programs, and to the principle of interprovincial fiscal capacity equalization. The largest of these payments is made in respect of health care and post-secondary education under Established Programs Financing (EPF). Funds are also transferred under the Fiscal Equalization program, the Fiscal Stabilization program, and the Personal Income Tax Revenue Guarantee.

Although often discussed in terms of federal-provincial negotiation and agreement, the fiscal arrangements are under the sole legislative and administrative control of the federal government. Legislation in this area is drafted and enacted by the federal government, and requires no provincial enabling legislation, support or even agreement to operate.

Established Programs Financing

Adopted in 1977 to replace the federal-provincial shared-cost programs in the fields of health and post-secondary education, EPF was regarded as a milestone in co-operative federalism in Canada. The essence of the new arrangement was that the provinces, long dissatisfied with the cumbersome and inflexible nature of the cost-sharing arrangements, were given greater policy and administrative latitude through a move to block funding. At the same time, Ottawa lessened its financial risk by tying its contributions to the rate of growth of the national economy rather than to provincial expenditures.

Shortly after the new arrangement had been agreed upon, the federal government decided to keep track of the individual cash components of the transfers for health and post-secondary education. While not consistent with the principle of block funding, the split was for federal bookkeeping purposes only and did not require provinces to demonstrate that they had, in fact, spent the funds in these areas.

The *Canada Health Act*, passed by Parliament in 1984, sets program criteria and conditions of payment for the cash portion of transfers paid to the provinces for insured health care services and extended health care. Under the terms of the legislation, each province's health insurance plan must satisfy federal requirements respecting comprehensiveness, portability, universality, accessibility and public administration.

The federal government is empowered to withhold a portion of the provincial transfer payments equal to the amount that physicians bill above the rates set out in the provincial

fee schedules. Dollar for dollar deductions are also imposed on provinces that permit user charges. Between July 1984 and June 1986, over $106 million in payments to Ontario were withheld by the federal government. The Province has since complied with the conditions of the *Canada Health Act* by eliminating extra-billing for insured health services and has recouped the amount withheld.

As shown in Table 8, the federal government has taken a number of further actions to restrain the growth of its payments to the provinces. When the fiscal arrangements were amended in 1982, the Revenue Guarantee Compensation, which was built into EPF as part of the 1977 agreement, was removed. This effectively eliminated a portion of the per capita entitlements.

EPF transfer growth is based on both growth in the economy and population increases for individual provinces. Under the two-year federal "6 & 5" restraint program introduced in June 1982, per capita limits were imposed on post-secondary education transfer growth.

The federal government's Bill C-96 received Royal Assent in June 1986. It reduced the annual growth in per capita EPF transfers by two percentage points.

More recently, the federal government's Bill C-33, *An Act to amend the Federal-Provincial Fiscal Arrangements and Federal Post-Secondary Education and Health Contributions Act*, received First Reading on June 27, 1989. If passed, it would reduce the annual growth in per capita EPF transfers by an additional one percentage point, beginning in 1990-91. Taken together, the reductions in EPF entitlements for Ontario exceed $1.2 billion in 1989-90, and will amount to almost $1.6 billion in 1990-91. EPF cash payments to Ontario, which represent about seven per cent of total budgetary revenue, are expected to be $2.7 billion in 1989-90.

Ontario Losses Due To Federal Reductions in Annual EPF[1] Growth Since 1982 **Table 8**
($ Million)

	Elimination of Revenue Guarantee Compensation	"6 & 5" Caps on PSE[2] Transfers	1986-87 Reduction of EPF[1] Escalator	1990-91 Reduction of EPF[1] Escalator	Total Ontario	Total All Prov.[3]
1982-83	293	-	-	-	293	827
1983-84	323	41	-	-	365	1,027
1984-85	354	90	-	-	444	1,246
1985-86	382	98	-	-	480	1,341
1986-87	417	106	114	-	637	1,772
1987-88[4]	452	115	245	-	812	2,246
1988-89[4]	489	125	396	-	1,010	2,776
1989-90[4]	531	136	567	-	1,234	3,380
1990-91[5]	580	148	766	74[6]	1,568	4,270
TOTAL	3,821	860	2,088	74	6,842	18,884

1 Established Programs Financing.
2 Post-Secondary Education.
3 Includes Territories.
4 Based on federal interim estimates of EPF entitlements.
5 Forecast.
6 Provincial/territorial losses resulting from the latest federal EPF reduction will total an estimated $200 million in 1990-91.
Note: Figures may not add due to rounding.
Source: Department of Finance, Canada; Ontario Ministry of Treasury and Economics.

Federal support for Ontario health and post-secondary education programs has fallen from a peak of 52 per cent of provincial-local spending for these purposes in 1979-80 to under 38 per cent in 1989-90.

Equalization

Equalization payments are unconditional transfers from the federal government to qualifying provinces with the purpose, as enshrined in Section 36 of the *Constitution Act, 1982*, of ensuring that provincial governments have sufficient revenues to provide "reasonably comparable levels of public services at reasonably comparable levels of taxation". The actual determination of equalization entitlements has evolved over the years by refinements and adjustments to the formula since the inception of the program in 1957. Although there have been disagreements about these changes, some of which have had quite dramatic effects, all provinces have supported the overall thrust of the Fiscal Equalization Program.

Ontario has never received equalization payments. Indeed, when oil price shocks created the possibility of Ontario receiving equalization payments, these equalization payments were prevented through a retroactive legislative amendment in 1981.

The current "five-province standard" of fiscal capacity replaced a national average standard in 1982. This change, combined with a number of tax base modifications, tended to disadvantage Quebec and Manitoba. Accordingly, a transitional guarantee was incorporated into the formula. The transitional guarantee provided that no province could receive less under the new formula than it received in the last year of the old formula. Provision was made for a specified amount of growth.

As Table 9 illustrates, all provinces except Alberta, British Columbia and Ontario receive federal equalization transfers.

Estimated Equalization Entitlements by Province, 1989-90 **Table 9**

	($ Million)	($ Per Capita)
Newfoundland	910	1,602
Prince Edward Island	184	1,415
Nova Scotia	854	961
New Brunswick	836	1,165
Quebec	3,449	517
Manitoba	768	703
Saskatchewan	351	346
Total	7,353	664

Notes: 1 Figures may not add due to rounding.
2 Ontario, Alberta and British Columbia do not receive equalization payments.

Source: Department of Finance, Canada: Provincial Fiscal Equalization, First Estimate, 1989-90 (January, 1989).

For 1989-90, the current estimate of total equalization entitlements is $7.4 billion. The sole legislative constraint on the growth of equalization entitlements is that aggregate transfers must not exceed the year-over-year increase in GNP. So far, this ceiling has not had to be applied. Although Quebec receives the highest absolute share of total equalization ($3.4 billion), its per capita share ($517) is second-lowest among recipient provinces.

Fiscal Stabilization

In order to protect provinces from sudden year-over-year losses in revenue resulting from an economic downturn, the federal government has provided for Fiscal Stabilization payments. These unconditional cash transfers ensure that each province's tax revenues, measured on the basis of constant tax rates and structure, plus its equalization payments, will not be less than they were in the previous year.

In 1987-88, the federal government introduced, among other technical changes, an annual ceiling of $60 per capita for grant assistance. Fiscal Stabilization entitlements exceeding this limit are provided as interest-free loans repayable within five years. To date, two provinces have received payments under this program. British Columbia received $175 million in respect of the 1982-83 fiscal year and Alberta has received a $75 million interim payment as part of an unresolved claim for 1986-87. However, Fiscal Stabilization payments provide an important guarantee for many provinces.

Personal Income Tax Revenue Guarantee

Since provinces set Personal Income Tax rates in relation to the Basic Federal Tax, the federal Personal Income Tax Revenue Guarantee provides limited compensation to provinces when federal tax policy changes reduce provincial revenues within a taxation year. Compensation is provided for the amount that Personal Income Tax revenue losses exceed 1.0 per cent of basic federal tax for the province. The only Revenue Guarantee payment made to date has been $4.3 million to Saskatchewan in respect of the 1985 taxation year.

Canada Assistance Plan

The Canada Assistance Plan (CAP) was established by federal legislation in 1966 as a cost-sharing mechanism for provincially-administered social assistance and welfare programs. The Canada Assistance Plan replaced the targeted shared-cost programs that provided assistance for the elderly, the blind, the disabled and the unemployed. By the end of the 1960s, these programs had come under increasing criticism for their eligibility restrictions. The new program was designed to bring a measure of order and coherence to fragmented provincial public assistance systems.

Since its inception, federal payments under CAP have increased from $0.3 billion in 1967-68 to an estimated $4.8 billion in 1989-90 according to Canada Main Estimates. This makes CAP the third-largest source of transfer payments to the provinces after Established Programs Financing and Equalization. Ontario revenue from CAP is expected to total $1.8 billion* in 1989-90.

The Canada Assistance Plan is intended to act as a safety net. Under its provisions, the federal government contributes an amount equal to 50 per cent of provincial expenditures on assistance payments (food, shelter and clothing) to individuals in need, and on a range of services, including child welfare, child care, homemaker services for the elderly, institutions for the disabled and family counselling. To qualify for federal CAP funds, provincial welfare service programs must be designed to benefit those "in need or likely to become in need". As well, potential beneficiaries must demonstrate their eligibility through either a needs test or an income test, as determined by each province and subject to federal guidelines.

The Canada Assistance Plan has been the subject of numerous reviews during the last two decades. In 1970-71, the Senate Committee on Poverty issued a report that was critical of CAP and recommended that it be replaced by a guaranteed annual income. Ten years later,

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* Includes Civil Legal Aid.

negotiations were underway to remove social services from CAP and provide them through a block fund under a proposed *Social Services Financing Act*, modelled after the Established Programs Financing. The proposal, however, was withdrawn when the provinces refused to accept a reduction in the Established Programs Financing escalator to GNP growth less one per cent. The proposal to replace the federal share of CAP and other federal tax and transfer programs, such as family allowances and child tax credits, with a guaranteed annual income, was resurrected by the Macdonald Commission in 1985 when it recommended the adoption of a Universal Income Security Program.

More recently, the Nielsen Task Force on Program Review found no support for a major revision of CAP. However, its report did register concern over the trend toward long-term dependence on assistance among "employables" and warned of the danger that future CAP costs may become unaffordable as a result. The Nielsen review concluded that it may be necessary to change the open-ended nature of CAP funding by limiting federal spending under the agreement. However, the Canada Assistance Plan remains a singular example of intergovernmental collaboration and cost-sharing of major social programs available across Canada.

Canada Child Care Act

Provincial child care expenditures for this fiscal year are estimated at $364 million, an increase of 310 per cent from the 1984-85 level.

On September 26, 1988, the House of Commons passed the *Canada Child Care Act*, to enable the federal government to enter into cost-sharing agreements to contribute to provincial child care programs. The Act died during Senate review with the September 30 dissolution of Parliament, and has not been reintroduced.

The proposed *Canada Child Care Act* would have provided for the replacement of open-ended contributions to Ontario child care programs with a maximum $1.7 billion in federal program contributions over the 1988 to 1995 period. Subject to annual federal funding limits, Ottawa's contributions would have included 75 per cent reimbursements for capital grants for approved not-for-profit child care facilities, as well as 50 per cent reimbursements for operating grants for all approved child care centres.

Provinces would have maintained the option to continue current federal cost-sharing of child care expenditures under the Canada Assistance Plan as an alternative to converting to an arrangement under the proposed *Canada Child Care Act*.

The 1989 federal budget announced a deferral of new cost-sharing arrangements for provincial child care programs, with a commitment by the federal government to act to meet its child care objectives before the end of its term of office. In the interim, the Canada Assistance Plan will continue to share the cost of eligible Ontario child care services.

Provincial-Local Transfers

In 1989-90, the Province will provide close to $4.5 billion in financial support to municipalities and municipal agencies, as indicated in Table 10.

Provincial support to school boards also amounts to almost $4.5 billion, including nearly $310 million in capital assistance.

Highlights of Provincial Transfers to Local Governments **Table 10**
($ Million)

	Budget Outlook 1989-90
Transfers to Municipalities	
Unconditional	871
Roads	678
Transit	393
Social Services	1,571
Health	219
Environmental	184
Recreational & Cultural	92
Other*	490
Total Municipal Transfers	4,498
Transfers to School Boards	
General Legislative Grants**	4,153
Capital Grants	310
Total School Transfers	4,463
Total Transfers Allocated	8,961
Advances***	(413)
Total Transfers to Local Government	8,548

* Includes additional funding for northern roads from the Ministry of Northern Development and Mines.
** An additional $7.5 million was added to the Ministry of Education allocation in the 1989-90 Printed Estimates.
*** For 1988-89, $300 million for school capital grants and $413 million for Unconditional Grants were advanced from 1989-90. For 1989-90, the $300 million allocated for school capital grants will be advanced from 1990-91.
Source: Ontario Ministry of Treasury and Economics.

Transfers to Municipalities

Transfer payments to municipalities are estimated to increase by $333 million over 1988-89 levels, to $4.5 billion in 1989-90. This represents an increase of almost 8 per cent.

The Province provides financial assistance to municipalities through conditional and unconditional grant payments. Conditional grants are generally provided on the stipulation that these funds be used for a specific program or service within the municipality. Conditional grants are subject to eligibility criteria and spending conditions and municipalities are often required to contribute financially to the program. The majority of conditional grants are for transportation, health, social services, the environment, and culture and recreation.

Unconditional grants, on the other hand, provide financial assistance to municipalities that may be spent in any manner decided by municipal council. These grants are delivered through the Ontario Unconditional Grants Program.

The Province advanced $413 million of 1989-90 Unconditional Grants entitlements to municipalities in 1988-89. This initiative provided a cash flow advantage to municipalities. For 1989-90, Unconditional Grants payments are being maintained at their 1988-89 levels.

At present, both the conditional and unconditional grants programs are being reviewed by the Province with the aim of developing a more efficient, equitable and responsive system for delivering grants. Recently, an Advisory Committee on Provincial-Municipal Financing Matters was established to provide advice to the Minister of Municipal Affairs in exploring creative responses to financing pressures faced by both levels of government. One of the Committee's directives is to provide recommendations concerning the transfer payments system.

The average annual growth in Provincial support to the municipal sector has significantly outpaced inflation in Ontario over the last five years. As Table 11 indicates, total operating transfers increased by more than twice the rate of inflation (4.3 per cent). This reflected increased Provincial support in areas such as health and social services.

Provincial Transfers to Municipalities **Table 11**
($ Million)

	1984-85	Outlook 1989-90	Average Annual Increase (%)
Unconditional	720	871	3.9
Conditional	1,419	2,417	11.2
Operating	2,139	3,288	9.0
Capital	940	1,210	5.2
Total Transfers	3,079	4,498	7.9

Source: Ontario Ministry of Treasury and Economics.

The growth in capital transfers also outpaced inflation, reflecting increased Provincial capital activity in environmental and transit projects. Despite maintaining 1989-90 road grants at 1988-89 levels, road transfers have increased by about 34 per cent since 1984-85.

Municipal Sector Performance

Municipal spending in 1989 is expected to grow by 15.5 per cent, well above the compound average annual growth of about 10 per cent between 1984 and 1989. Capital spending, which accounts for less than a quarter of total expenditures, is expected to increase by 32 per cent. Growth continues to be led by areas served by regional governments. In general, these areas are experiencing above-average service growth as measured by the growth in households. It should also be noted that individual municipal patterns of growth within these areas can vary considerably. By comparison, Table 12 shows that, for municipalities not within regional governments, spending growth is expected to average only 7.1 per cent.

Estimated Municipal Spending, 1988 & 1989 **Table 12**
($ Million)

	Preliminary 1988	Projected 1989	Increase %
Municipalities within Metropolitan Toronto*	3,991	4,731	18.5
Municipalities within Regions*	5,073	6,032	18.9
All Governments in Regions*	**9,064**	**10,763**	**18.7**
Municipalities within Counties*	2,701	2,915	7.9
Municipalities within Districts	772	806	4.4
All Other Governments	**3,473**	**3,721**	**7.1**
Total Municipal Sector	**12,537**	**14,484**	**15.5**

* Includes upper and lower tier governments.
Source: Ontario Ministry of Municipal Affairs.

As shown in Table 13, the proportion of municipal financing accounted for by transfers and municipal property taxes has dropped over the period, with the difference being made up by other revenues and user fees.

Municipal Revenue Mix **Table 13**
(Per Cent)

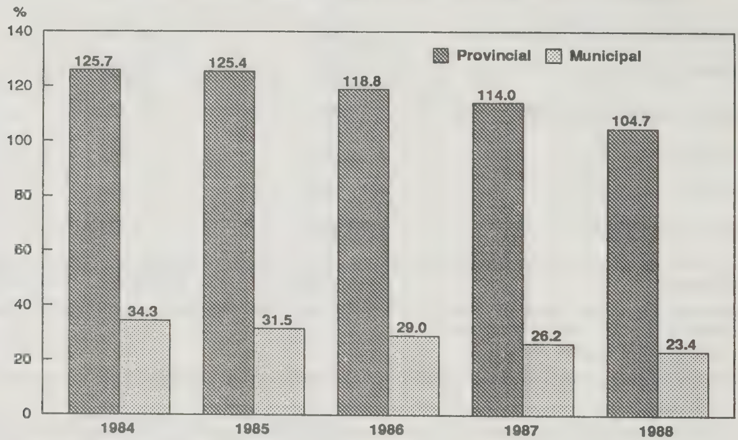
	1984	Projected 1989
Property Taxation*	40.4	38.5
Provincial Grants	32.1	28.0
All Other Revenues	27.5	33.5
	100.0	100.0

* Includes water and sewer billings.
Source: Ontario Ministry of Municipal Affairs.

As a group, municipalities are in a better position than the Province with respect to their debt burdens, although exceptions do exist on a case-by-case basis. (See the following chart.) "Debt" includes total long-term debt and Ministry of The Environment sewer and water project debt. In 1988, total municipal own-purpose debt was approximately $3 billion, slightly over

23 per cent of total annual revenues. By comparison, total Provincial own-purpose debt was approximately 105 per cent of annual budgetary revenue. Public debt interest payments are estimated at 10.8 per cent of annual revenues for the Province in 1988 -- higher than the 5 per cent estimated for municipalities.

OWN-PURPOSE DEBT AS A PER CENT OF ANNUAL REVENUE*



* 1988 Municipal Affairs' data is preliminary.

Sources: Ontario Ministry of Treasury and Economics and Ontario Ministry of Municipal Affairs.

Between 1987 and 1988, municipal long-term borrowing grew by 23.8 per cent and reached $458 million, reflecting strong growth in capital expenditures. This was a substantial increase over recent years (1984 to 1987) in which the compound average annual growth was 11.5 per cent.

Under the provisions of the Municipal Act, a municipality may not budget for a surplus or deficit in its revenue fund or operating account. The Ontario Municipal Board provides guidelines for measuring a municipality's ability to take on increased debt. As a general rule, the Board has determined that a municipality should not commit to spend more than 20 per cent of its annual operating expenditures on debt servicing. Despite the increase in borrowing, municipalities as a whole retain a significant capacity to assume debt for capital projects or other major requirements, although significant exceptions do exist particularly within the Greater Toronto Area. Table 14 shows the most recent estimates of municipal capacity to borrow funds, excluding debt assumed on behalf of school boards and Provincially-guaranteed debt.

Estimated Municipal Debt Capacity, 1988 **Table 14**
($ Million)

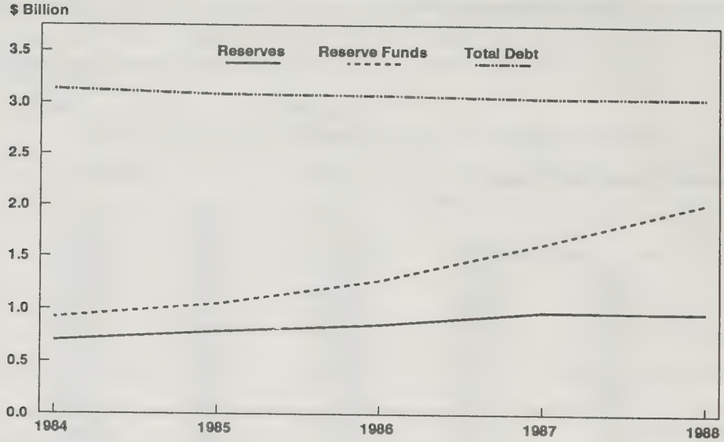
	Total Debt Capacity	Available Debt Capacity	
		$	%
Municipalities within Metropolitan Toronto*	3,382	2,512	74.3
Municipalities within Regions	3,589	2,453	68.3
All Governments in Regions*	**6,971**	**4,965**	**71.2**
Municipalities within Counties*	2,146	1,875	87.4
Municipalities within Districts	635	572	90.1
All Other Governments	**2,781**	**2,447**	**88.0**
Total Municipal Sector	**9,752**	**7,412**	**76.0**

* Includes upper and lower tier governments.
Source: Ontario Ministry of Municipal Affairs.

Municipal Reserves and Reserve Funds

The following chart shows that monies set aside in reserve funds grew steadily between 1983 and 1988. These are revenues set aside by municipalities to finance operating and capital expenditures at some future time. Reserves are generally used for such operating purposes as contingencies and sick-pay credit programs. Reserve funds are created by municipal councils for future capital projects. They represent an alternative to long-term borrowing for municipal councils.

TOTAL DEBT, RESERVE FUNDS AND RESERVES



Source: Financial Information Returns filed with the Ministry of Municipal Affairs, 1984 to 1988 (preliminary).

Education Finance

The funding of elementary and secondary education in Ontario is shared between the Province and local school boards. The Provincial share is distributed to school boards through the General Legislative Grants and capital programs with the school board share being raised from local property taxes.

Ontario is providing $4,161 million in operating grants to school boards in 1989-90. This is up 6.3 per cent from $3,914 million in 1988-89.

In addition, the Province has made a four-year commitment of $300 million per year for school capital beginning in 1989-90, for a total of $1,200 million. In 1989-90, $310 million has been allocated. This is up from $72 million in 1984-85, an increase of more than 300 per cent.

Bill 20, the *Development Charges Act*, is currently before the Legislature. This Act would give school boards the additional financing option of establishing lot levies for new school construction. Further, the Act provides for school boards and developers that wish to negotiate innovative financing arrangements, as an alternative to lot levies. A related piece of legislation entitled Bill 18, an Act to amend the *Ontario Municipal Improvement Corporation Act*, will give school boards access to $200 million in lower-cost Canada Pension Plan financing for school construction.

School funding is a significant component of government spending at both levels, as shown in Table 15.

Education Finance in Perspective **Table 15**
(Per Cent)

	Outlook 1989-90
Transfer Payments to School Boards	
Relative to Total Local Transfers	49.9
Relative to Provincial Budgetary Expenditure	10.8
School Finance in the Local Sector	
School Board Operating Spending Relative to Total Local Operating Spending	47.6
Average Residential School Taxes Relative to Total Property Taxes*	48.0

* On a per-household basis.
Source: Ontario Ministry of Treasury and Economics.

APPENDICES

I. Tax Expenditures

II. Fiscal Capacity and Tax Effort

III. Glossary of Terms

APPENDIX I

Tax Expenditures

**Personal Income Tax Expenditures
Estimates of Ontario Revenue Foregone
in the 1989 Taxation Year**
($ Million)

Table 1

	Ontario Revenue Foregone
Tax Expenditures Shared with the Federal Government	
Deductions and Exemptions	
Registered Retirement Savings Plan Contributions	583
$100,000 Lifetime Capital Gains Exemption	400
Registered Pension Plan Contributions	272
Capital Gains Exclusion	260
Carrying Charges	117
Union Dues	64
Child Care Expenses	46
Moving Expenses	15
Non-Refundable Tax Credits	
Basic Personal Credit	3,123
Married Credit (including Equivalent-to-Married)	300
Age Credit	194
Charitable Donations	188
Canada Pension Plan Contributions	157
Unemployment Insurance Premiums	132
Credit for Dependent Children	74
Pension Income Credit	49
Medical Expenses	30
Disability Credit	30
Tuition Fees	25
Education Credit	10
Tax Expenditures Solely Within Ontario's Jurisdiction (1989-90)	
Ontario Health Insurance Plan Premium Assistance*	595
Ontario Tax Grants to Seniors*	505
Ontario Property and Sales Tax Credits	444
Ontario Tax Reduction	40
Ontario Home Ownership Savings Plan Tax Credit	30
Ontario Political Contribution Tax Credit	5

* Although not directly part of the Personal Income Tax system, these tax expenditures provide benefits to individuals. OHIP premium payments and assistance end December 31, 1989.

Source: Ontario Ministry of Treasury and Economics.

Corporate Tax Expenditures
Estimates of Ontario Revenue Foregone in Full Year 1989-90
($ Million)

Table 2

	Ontario Revenue Foregone
Corporate Income Tax	
Small Business Deduction	435
Capital Cost Allowance vs. Accounting Depreciation	210
Employer Health Tax (reduced rates for small employers)	190
Capital Gains Exclusion	150
Reduced Rate for Specified Sectors	88
Current Cost Adjustment	83
Research and Development Super Allowance	56
Exploration and Development Expenses	15
Resource Allowance	2
Small Business Development Corporations Program	1.3
Ontario Mineral Exploration Program	0.2
Capital Tax	
Flat Capital Tax for Small Business	100
Mining Tax	
Three-Year Mining Profits Tax Exemption for New Mines	5
$500,000 Mining Profits Exemption	3

Source: Ontario Ministry of Treasury and Economics.

Retail Sales Tax Expenditures **Table 3**
Estimates of Ontario Revenue Foregone in 1989-90
($ Million)

	Ontario Revenue Foregone
Services	
Professional	3,981
Commercial	2,189
Personal	1,831
Transient Accommodation	42
Admission fees	30
Goods	
Energy (including motive fuels)	1,836
Basic Groceries	1,200
Production Machinery	909
Reading Materials	168
Prepared Foods	120
Soil and Water	120
Prescription Drugs	110
Children's Clothing	60
Aircraft	57
Medical Equipment	28
Footwear	27
Feminine Hygiene Products	11
Purchaser Specific - All goods and services tax exempt or tax rebated	
Farmers	207
Visitors to Ontario	25
Hospitals	15
Religious/Charitable	11
Disabled Persons	8
Fisherpersons	1
Fur-trappers	1
Museums/Galleries	1
Municipalities (fire trucks)	1

Source: Ontario Ministry of Treasury and Economics.

Personal Income Tax Expenditures
1989 Tax Rules

Tax Expenditures Shared with the Federal Government

Deductions and Exemptions

Registered Retirement Savings Plan Contributions - Contributions are deductible from income up to prescribed limits. The allowable contribution for each year is governed by the maximum limit for that year ($7,500 in 1989), the individual's income and the amount of any contributions to a registered pension plan.

$100,000 Lifetime Capital Gains Exemption - Taxpayers are permitted a cumulative lifetime capital gains exemption of $100,000.

Registered Pension Plan Contributions - Employee contributions as required under the pension plan are deductible from income.

Capital Gains Exclusion - One-third of capital gains are income tax-exempt.

Carrying Charges - Individuals may deduct from income the interest cost on money borrowed to make investments, fees for investment counselling and other investment-related expenses.

Union Dues - Annual dues for membership in qualifying organizations are deductible from income.

Child Care Expenses - Expenses paid for child care services that enable single parents or both spouses in a two-parent family to earn income or attend an educational or training program are deductible from income. The maximum deduction is $4,000 for each child under the age of 7 and $2,000 for each child age 7 and over.

Moving Expenses - Unreimbursed moving expenses may be deducted from income by those who move at least 40 kilometres closer to their new workplace.

<u>Non-Refundable Tax Credits</u>*

Basic Personal Credit - A credit of $536 is available to every taxfiler.

Married Credit (including Equivalent-to-Married) - A credit of up to $447 is available to a taxfiler in respect of a dependent spouse or, if not married, in respect of an eligible dependent living with the taxfiler.

Age Credit - The age credit of $289 is available to all taxfilers age 65 and over.

Charitable Donations - A credit is available in respect of charitable donations and for gifts to Canada or a province, or for gifts of cultural property.

Canada Pension Plan Contributions - A credit of up to $46 is available for required contributions.

Unemployment Insurance Premiums - A credit of up to $54 is available for required premiums.

Credit for Dependent Children - A credit of $35 may be claimed in respect of each dependent child under age 19, with the credit doubled for the third and subsequent children in the family.

Pension Income Credit - This provision allows individuals, mostly seniors, to claim a credit of up to $88 in respect of their eligible pension income.

Medical Expenses - A credit is available in respect of out-of-pocket medical and dental expenses in excess of 3 per cent of Net Income.

Disability Credit - This credit of $289 is available to taxpayers who meet prescribed disability criteria.

Tuition Fees - A student may claim a credit in respect of eligible tuition fees, with any unused credit portion transferable to a supporting taxpayer.

Education Credit - This credit is for full-time students and is based on the number of months of attendance, with any unused credit portion transferable to a supporting taxpayer.

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* The income tax return does not show any amounts for Provincial non-refundable income tax credits. The value of these credits in respect of individual Ontario tax payable has been estimated by multiplying each federal credit by Ontario's tax rate of 52 per cent in 1989.

Tax Expenditures Solely Within Ontario's Jurisdiction

Ontario Health Insurance Plan Premium Assistance - This program eliminates or reduces OHIP premiums for low-income families and specified groups.

Ontario Tax Grants to Seniors - Property tax grants of up to $600 and sales tax grants of $50 are available to those age 65 and over.

Ontario Property and Sales Tax Credits - This program provides refundable tax credits to low and moderate-income people under age 65 to reduce their property and sales tax burden.

Ontario Tax Reduction - This program eliminates or reduces Ontario Income Tax of up to $150 for low-income taxfilers.

Ontario Home Ownership Savings Plan Tax Credit - This program provides refundable tax credits of up to $500 for individuals and $1,000 for families saving for the purchase of a first home.

Ontario Political Contribution Tax Credit - A tax credit of up to $750 is available to offset a portion of contributions made to registered provincial political parties.

Corporate Tax Expenditures 1989 Tax Rules

Corporations Income Tax

Small Business Deduction - Canadian-controlled private corporations that qualify for the federal small business deduction are eligible for a reduction of the Ontario Corporations Income Tax rate to 10 per cent on the first $200,000 of eligible income annually.

Capital Cost Allowance vs. Accounting Depreciation - The capital cost allowance system allows companies to expense capital assets for tax purposes at a rate that generally exceeds accounting depreciation.

Capital Gains Exclusion - One-third of most capital gains are taxable, and one-third of capital losses can be used to offset taxable capital gains.

Reduced Rate for Specified Sectors - A one per cent tax rate reduction is provided for income earned from manufacturing, processing, mining, logging, farming, and fishing.

Current Cost Adjustment - Provides a direct deduction from income otherwise subject to tax equal to a percentage of the purchase price of new manufacturing and processing machinery and air and water pollution control equipment purchased for use in Ontario.

Research and Development Super Allowance - Provides a deduction from income otherwise subject to tax equal to a percentage of current and capital expenditures on research and development incurred in Ontario.

Exploration and Development Expenses - All Canadian and Ontario exploration and development expenses associated with mining activities are fully deductible.

Resource Allowance - Provides a tax deduction equal to a percentage of resource profits earned from the production of oil and gas and minerals.

Small Business Development Corporations Program - This program entitles investors to receive an Ontario Government grant (for individuals) or a tax credit (for corporations) based on the amount invested in eligible small businesses through an approved Small Business Development Corporation.

Ontario Mineral Exploration Program - Junior exploration companies, i.e. non-producing, may receive a tax credit or grant equal to 25 per cent of eligible exploration expenses.

Capital Tax

Flat Capital Tax for Small Business - Certain small corporations are either exempt from payment of capital tax or subject to a reduced flat rate of tax.

Mining Tax

Three-Year Mining Tax Exemption for New Mines - Income earned from a new mine or a major expansion of an existing mine is exempt from mining tax for the first three years of commercial production.

$500,000 Mining Income Exemption - An exemption is provided annually on the first $500,000 of mining income.

Retail Sales Tax Expenditures
1989 Tax Rules

Services

Professional - Professional fees are exempt from RST.

Commercial - Most commercial services are exempt from RST.

Personal - Most personal services are exempt from RST.

Transient Accommodation - Transient accommodation is taxed at a reduced rate of 5 per cent.

Admission Fees - All admission fees to places of amusement costing $4 or less and other specific events are exempt from RST.

Goods

Energy - All forms of energy, including motive fuels, are exempt from RST.

Basic Groceries - All grocery store food, except soft drinks, snack foods and confections, are exempt from RST.

Production Machinery - Production machinery and equipment and subsequent repairs are exempt from RST.

Reading Materials - Magazines purchased by subscription, books and newspapers are exempt from RST.

Prepared Foods - Prepared food priced at $4 or less is exempt from RST.

Soil and Water - Soil, clay, sand, gravel, unfinished stone and natural water are exempt from RST.

Prescription Drugs - All drugs prescribed by a doctor, dentist or veterinarian are exempt from RST.

Children's Clothing - Children's sized clothing is exempt from RST.

Aircraft - Commercial aircraft and parts, equipment and repairs for such aircraft are exempt from RST.

Medical Equipment - Hearing aids, dental and prescription optical appliances are exempt from RST.

Footwear - Footwear priced at $30 or less is exempt from RST.

Feminine Hygiene Products - Tampons, sanitary pads and sanitary belts are exempt from RST.

<u>Purchaser Specific</u>

Farmers - Most implements, machinery and repairs, and agricultural products are exempt from RST when purchased by a person engaged in farming.

Visitors to Ontario - Out-of-province visitors to Ontario are eligible for a refund of RST paid on certain items.

Hospitals - Medical and surgical equipment purchased by a hospital is exempt from RST.

Religious/Charitable - Used clothing and/or footwear sold by these organizations for $50 or less and meals sold at a nominal charge are exempt from RST. These organizations' purchases of publications, items used for worship, and construction materials are exempt from RST under certain conditions.

Disabled Persons - Most prosthetic and orthopaedic devices are exempt from RST. A rebate for RST paid on purchases of vehicles used to transport persons with physical disabilities is available, to a maximum of $1,600 for cars and $2,400 for vans.

Fisherpersons - Certain fishing equipment, including vessels, is exempt from RST when purchased by commercial fisherpersons.

Fur-Trappers - Trapping equipment purchased by a licensed trapper is exempt from RST.

Museums/Galleries - Works of art purchased by a museum or art gallery are exempt from RST if 50 per cent or more of the establishment's revenue is provided by public donations or grants.

Municipalities (fire trucks) - Fire-fighting vehicles priced at more than $1,000 and purchased for exclusive use of a municipality, public hospital, university, local service board or volunteer group are exempt from RST.

APPENDIX II

Fiscal Capacity and Tax Effort

Fiscal capacity measures the relative ability of a province to raise revenues from available revenue sources. Tax effort measures the relative extent to which each province taxes those available revenue sources. In this section, these measures are used to make interprovincial comparisons.

Determination of Fiscal Capacity

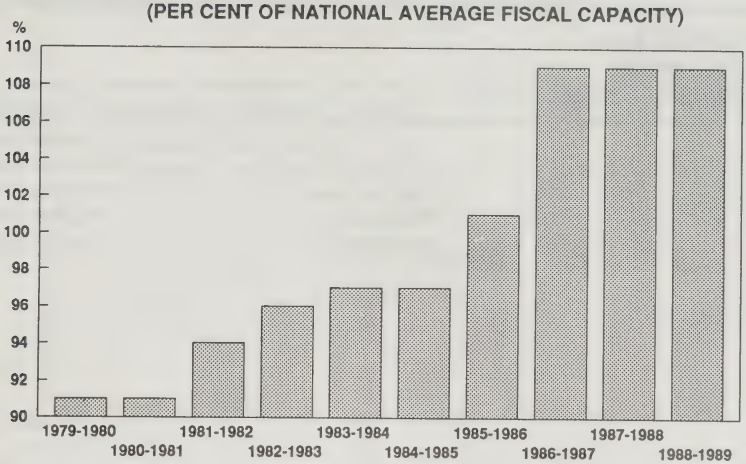
Fiscal capacity can be measured by a number of different indices.

The Representative Tax System (RTS) is the one used by the federal and provincial governments as a measurement of fiscal capacity. In the Representative Tax System, each revenue source has an associated tax base and the fiscal capacity can be related to population. For example, the base for tobacco taxes is the number of cigarettes sold in a province. If a province's share of a base is lower than its population share, that province is said to have a fiscal capacity deficiency in that tax base. If the opposite is true, a fiscal capacity surplus exists. In other words, a province has a fiscal capacity deficiency in a tax base if its per capita share of a base is less than the national average.

Tax bases are defined according to the taxing practices of provinces. For example, if an item such as infants' clothing is exempt from the retail sales tax in a majority of the provinces, such sales would not be included in the tax base. Hence, the term "representative".

Employing data from the federal Equalization Program, it is possible to derive an aggregate tax base share by adding together 37 different provincial and local tax bases. This provides a single, comprehensive measure of a province's relative fiscal capacity. In 1988-89, Ontario's fiscal capacity, measured on this basis for provincial-local own-source revenues, was 109 per cent of the national average. The chart below indicates how Ontario's fiscal capacity has varied over the past ten years.

FISCAL CAPACITY OF ONTARIO
(PER CENT OF NATIONAL AVERAGE FISCAL CAPACITY)



Notes: Data for 1987-88 and 1988-89 are subject to revision.
Index for 1987-88 is based on phased-in value of tax base change in 1987 Fiscal Arrangements Regulations.

Source: Department of Finance, Canada.

As Table 1 shows, own-source fiscal capacities in 1988-89 ranged from 62 per cent for Newfoundland to 137 per cent for Alberta. If federal transfer revenues are added to provincial-local own-source revenues, the fiscal capacity of "equalization-recipient" provinces approaches the national average. Since federal transfers are relatively large for the "equalization-recipient" provinces, the relative fiscal capacities of the "non-recipient" provinces decline. For example, Ontario's 1988-89 fiscal capacity declined 9 percentage points to 100 per cent of the national average, primarily because the Province does not receive federal equalization payments.

Indices of Provincial-Local Fiscal Capacity, 1988-89 **Table 1**
(Per Cent of National Average)

	Provincial-Local Own-Source Revenues	Provincial-Local Own-Source Revenues plus All Federal Transfers*
Newfoundland	62	95
Prince Edward Island	66	98
Nova Scotia	77	96
New Brunswick	72	98
Quebec	87	95
Ontario	**109**	**100**
Manitoba	83	94
Saskatchewan	90	95
Alberta	137	122
British Columbia	105	99
National Average	100	100

* Federal Transfers include federal 1988-89 Main Estimates only.
Note: Data are subject to revision.
Source: Department of Finance, Canada and Ontario Ministry of Treasury and Economics

Included in the determination of federal transfers are special contracting-out tax points that Quebec opted for in lieu of a portion of federal cash contributions under the Canada Assistance Plan and Hospital Insurance. The latter contributions were subsequently rolled into Established Programs Financing.

Determination of Tax Effort

A comparison of provincial tax rates on individual revenue sources (e.g., Sales Tax Rate) is often employed as a gauge of relative revenue-raising efforts. However, such comparisons alone do not provide a way of assessing a province's overall tax effort.

As with the determination of fiscal capacity, tax effort can be measured by individual revenue sources. For each revenue source, a national average tax rate can be calculated by dividing the provincial revenues collected by the total all-province tax base. A comprehensive measure of tax effort can then be calculated by dividing a province's share of total provincial-local revenues by its share of total tax base.

This measure of tax effort indicates to what extent a province is taxing what is available to be taxed, relative to the national average. Local revenues are included because of the varying

responsibilities that individual provinces allocate to their local governments. Table 2 provides the indices of relative tax effort for 1988-89 on this comprehensive basis.

Indices of Provincial-Local Tax Effort, 1988-89 **Table 2**
(Per Cent of National Average Tax Effort)

Newfoundland	99
Prince Edward Island	96
Nova Scotia	89
New Brunswick	96
Quebec	115
Ontario	**100**
Manitoba	111
Saskatchewan	103
Alberta	73
British Columbia	100
National Average	100

Note: Data are subject to revision.
Source: Department of Finance, Canada.

Ontario's overall tax effort is equal to the national average. Alberta's tax effort is about 27 per cent below the national average, mainly because it levies no sales tax and has the lowest personal income tax rates. Since Alberta's share of oil and gas revenues is about the same as its share of oil and gas tax bases, its resource taxation does not bias its tax effort.

Quebec has a very high tax effort, some 15 percentage points above the national average in 1988-89. Despite high rates of taxation on certain revenue sources, the Maritime provinces do not have a high degree of overall tax effort, due in large part to their relatively low levels of local property taxation.

APPENDIX III

Glossary of Terms

Ad Valorem Tax - A percentage-based tax, typically applied to a measure of value such as selling price.

Basic Federal Tax - The level of tax determined by applying the federal tax rate schedule to taxable income and subtracting non-refundable credits. It is not federal tax payable, which is basic tax adjusted by credits, surtaxes or reductions. Ontario's tax rate of 52 per cent in 1989 is applied to Basic Federal Tax to yield Basic Ontario Income Tax.

Canada Assistance Plan (CAP) - Federal-provincial cost-sharing mechanism for provincially-administered social assistance and welfare programs.

Capacity Utilization Rate - The ratio of actual output of an industry (plant, firm, or economy) to the output it could produce with its existing plant and equipment.

Computer-assisted design and computer-assisted manufacturing (CAD/CAM) - The use of electronic equipment to design and manufacture products. CAD/CAM permits design changes to be refined, tested and incorporated into manufacturing more quickly than traditional methods.

Consolidated Public Sector Debt - Debt incurred at all levels of Provincial jurisdiction, including the Province, Ontario Hydro, municipalities, hospitals, universities and colleges.

Consumer Price Index (CPI) - A monthly index measuring the retail prices of a fixed basket of goods and services purchased by consumers.

Consumption - The value of spending by consumers on goods and services, measured in current dollar terms (nominal) or adjusted for inflation (real). In Ontario, consumption accounts for approximately 55 per cent of Gross Domestic Product.

Cost-of-living Adjustment - An adjustment to incomes, wages or other payments to maintain previous purchasing power in the face of changing consumer prices.

Debt to Equity Ratio - The total debt of a corporation divided by its shareholders' total equity.

Deductions - Reductions in the income tax base, usually for specific expenses incurred in order to earn income.

Deficit - The amount by which budgetary expenditures exceed budgetary revenues.

Economies of Scale - Reductions in the average cost of production achieved by increasing the volume of output.

Equalization - Unconditional transfers from the federal government to qualifying provinces with the aim of ensuring that provincial governments have sufficient revenues to provide reasonably comparable levels of public service at reasonably comparable levels of taxation.

Established Programs Financing (EPF) - Federal block contributions to the provinces in respect of health care and post-secondary education.

Exemptions - Amounts deductible from income in recognition of specific personal circumstances or, in the case of sales taxes, items specifically excluded from the tax base.

Expenditures - Direct expenditures on government programs include payments for goods and services, interest on the public debt, salaries and employee benefits, transfer payments to individuals, municipalities and institutions, subsidies and grants, and the acquisition and construction of fixed assets.

Export - A good or service produced in one country or jurisdiction and sold to another.

Final Demand - Domestic and foreign purchases of goods and services produced for final use within the economy, excluding inventory change.

Final Domestic Demand - Purchases of goods and services for final use within the economy, excluding the foreign sector (exports and imports) and inventory change.

Fiscal Arrangements - Institutional vehicles through which the federal government transfers funds to the provinces as part of its commitment to shared-cost programs and interprovincial fiscal capacity equalization.

Fiscal Capacity - Measure of a province's ability to raise revenues from available revenue sources relative to other provinces.

Fiscal Policy - The use of the Government's spending and taxing power to affect the aggregate level of economic activity. Expansionary fiscal policy is generally characterized by an increase in discretionary spending or a tax cut.

Fiscal Stabilization - Unconditional cash transfers from the federal government to ensure that no province's tax revenues, measured on the basis of constant tax rates and structure, plus its equalization payments, will be less than they were in the previous year.

Greater Toronto Area (GTA) - Includes municipalities in the regions of Halton, Durham, Peel, York and Metropolitan Toronto.

Gross Borrowing - Total borrowing including borrowing necessary for debt retirement purposes.

Gross Domestic Product (GDP) - The value of goods and services produced within the geographic boundaries of an area, expressed either in current dollar value (nominal) or adjusted for inflation (real).

Gross National Product (GNP) - The value of a nation's total output of goods and services, expressed either in current dollar terms (nominal) or adjusted for inflation (real). The percentage change in real GNP is the usual measure of the real growth rate of the economy.

Group of Seven Countries - Canada, France, Italy, Japan, United Kingdom, United States and West Germany.

Guaranteed Debt - Debt which the Province agrees to honour if the borrowing party cannot or will not; primarily Ontario Hydro.

Household Formation - Net increases in new households in a period.

Import - A good or service which has been bought from another country or jurisdiction.

Inflation - A continuing rise in the general price level.

Interest Rate - The price paid (charged) by a borrower (lender) of money. Nominal interest rates are those actually paid; real interest rates are nominal rates less the expected rate of inflation. (Current rates of inflation are generally used as proxies for expected rates.)

Interest Service Ratio - Total interest payments taken as a per cent of cash flow of industrial corporations before interest and taxes are deducted.

Inventory - The total value of the various raw materials, goods in process, parts and finished goods held by a firm.

Inventory Accumulation - An increase in the level of inventories held in the economy.

Investment - The value of spending on capital goods such as houses, plant, machinery and equipment; may be measured in current dollar terms (nominal) or adjusted for inflation (real).

Just-in-time Production - A system of production in which parts are delivered to assembly plants when they are required, eliminating the need for warehousing by the assembler.

Labour Force - The total number of persons, age 15 and over, who are either employed or looking for work.

Marginal Tax Rates - A schedule of rates used to determine the amount of tax payable at various taxable income levels and on each additional dollar of taxable income.

Monetary Policy - The policies of the central bank (Canada - Bank of Canada; U.S. - Federal Reserve Board) that determine the availability and cost of credit (i.e., interest rates) in the economy. Tight (anti-inflationary) monetary policy restricts growth of the money supply, thus raising interest rates and reducing inflation by squeezing demand from the economy.

MUSH sector - Municipalities, universities, school boards, hospitals, colleges and libraries.

Net Borrowing - Gross borrowing less borrowing needed for debt retirements.

Net Cash Requirements or Surplus (NCR) - The sum of the deficit and the net balance of other accounts.

Net Migration - The difference between the total population coming into the province and the total population leaving.

New Industrialized Economies - Jurisdictions which have recently achieved middle-income status through rapid industrialization and surging exports. They include Hong Kong, Singapore, Taiwan and South Korea.

Nominal (GDP, consumption, investment, etc.) - Value in current dollars (i.e., not adjusted for inflation).

Non-Marketable Securities - Securities which may not be bought or sold in public capital markets.

Non-Public Borrowing - Borrowing from non-public sources of funds, usually pension funds like the Canada Pension Plan.

Numerically-controlled machine tools - Machine tools whose motions are controlled by computerized mathematical instructions, rather than directly by a human operator.

Operating Position - The difference between revenues and expenditures, excluding capital expenditures.

Organization for Economic Cooperation and Development (OECD) - An organization of industrial nations, with a permanent staff of officials, established in 1961 to improve trade and investment flows among its members, to analyze and deal with balance-of-payments and other economic problems and to coordinate foreign-aid policies.

Other Accounts - The lending, investment and special account administration activities of the Government, including loans, advances and investments, pension and related benefit funds and special purpose accounts. The transactions affect only asset and liability accounts.

Other Revenue - Total revenue minus taxation revenue and payments from the federal government. Major sources include OHIP premiums, LCBO and lottery profits, fees and licences and interest income.

Own-Purpose Debt - Debt issued by Ontario for Provincial purposes only. It excludes debt issued by Ontario on behalf of Ontario Hydro.

Paid-Up Capital - For most corporations, paid-up capital are funds invested in the corporation by its shareholders and other parties, loans or advances made to the corporation, and its cumulative undistributed corporate profit less its investment in other firms.

Participation Rate - The percentage of the population, age 15 and over, that is in the labour force.

Per Capita - Per person.

Per Point Yields - An estimate of direct revenue which would be gained or lost for a first unit change in tax rates.

Personal Disposable Income - The income remaining to persons for consumption or saving after deduction of income taxes and other legislated deductions, such as CPP premiums.

Personal Income - The income received by persons from all sources.

Personal Income Tax Revenue Guarantee - Federal program that compensates provinces when amendments to the federal *Income Tax Act* reduce, without notice, a province's Personal Income Tax revenues by more than one per cent of the Basic Federal Tax for the province.

Personal Savings Rate - Percentage of personal disposable income that is not spent on current consumption.

Prime Rate - The interest rate charged by chartered banks to their most credit-worthy customers.

Productivity - Output per unit of input (labour, capital, energy) employed.

Protectionism - Advocacy of protective tariffs and other barriers to trade as a means of developing national wealth.

Public Borrowing - Borrowing which is done through public capital markets.

Public Debt Interest - Interest paid by Ontario on total debt incurred for its own purpose.

Real (GDP, consumption, etc.) - Adjusted for inflation, constant dollar.

Recession - A downturn in the business cycle, characterized by weak economic activity and high unemployment. Two consecutive quarters of decline are generally considered to indicate a recession.

Recovery - The upturn of the business cycle following a recession, characterized by an increase in economic activity.

Representative Tax System - A series of thirty-seven distinct revenue sources used to determine what provinces, collectively, tax.

Revenue - Includes revenue raised through taxation, premiums, fees, licences and permits, payments from the federal government under the Fiscal Arrangements and shared-cost programs and income from investments.

Seasonal Adjustment (seasonally-adjusted) - A statistical adjustment to take account of seasonal factors, such as weather, so that data more accurately reflect underlying trends.

Specific Rate of Tax - A fixed rate per unit (e.g., gasoline is taxed at a rate of 10.3 cents per litre).

Surtax - A tax additional to Basic Ontario or Basic Federal Tax, usually calculated with reference to basic tax or to taxable income.

Tariff - A tax imposed on imported goods, levied either as a percentage of their value or according to the number of units imported.

Tax Base - The taxable value to which tax rates are applied (e.g., the taxable portion of income; or the value of goods and services taxed under the Retail Sales Tax).

Tax Collection Agreement - The agreement between each province and the federal government that authorizes the federal government to collect that province's Personal Income Tax. Under the current arrangements, the provinces agree to calculate their tax as a percentage of Basic Federal Tax, effectively waiving all rights to determine the tax base. Provinces are permitted limited credit and surtax/reduction programs. Some provinces have similar arrangements for Corporate Income Taxes.

Tax Credit - A reduction of certain taxes paid, with the amount of the credit determined by a specified formula. Ontario Tax Credits, for example, offset property and sales taxes for individuals by reducing Ontario Personal Income Taxes. The level of this credit is a function of both the amount of tax paid and the ability-to-pay of the individual. As a result, credit benefits fall as income rises, effectively redistributing tax burdens in favour of lower income individuals.

Tax Effort - Measure of the extent that a province actually taxes available revenue sources relative to other provinces.

Tax Expenditure - A specific incentive in the tax structure that reduces the normal amount of tax paid to a lower or zero amount.

Total Debt - Total liabilities of the Province issued for Provincial purposes.

Unemployment Rate - The number of persons in the labour market who are unemployed as a percentage of the labour force; may be either seasonally-adjusted or unadjusted (actual).

Unit Labour Cost - A measure of productivity calculated by dividing the total wage bill by the total number of units of a good or service produced.

Value-Added - The value of a firm's output minus the value of the inputs it purchases from other firms.

Review of Selected Financial and Economic Statistics
($ Million)

	1979-80	1980-81	1981-82	1982-83
Revenue	14,236	15,585	17,914	19,367
Expenditure	15,357	16,882	19,694	22,556
Deficit	1,121	1,297	1,780	3,189
Other Accounts - net	537	494	277	711
Net Cash Surplus/(Requirements)	(584)	(803)	(1,503)	(2,478)
Financial Position				
Total Debt	18,096	19,512	21,354	23,955
Provincial Debt Transactions - Proceeds net of Retirements	1,133	968	1,363	2,051
Gross Domestic Product (GDP) at Market Prices[1]	104,363	114,994	131,831	137,31
Personal Income[1]	84,607	94,411	110,033	122,44
Population - June ('000)	8,501	8,570	8,625	8,70
Total Debt per Capita (dollars)	2,128	2,277	2,475	2,75
Personal Income per Capita (dollars)	9,953	11,016	12,757	14,06
Expenditure as a per cent of GDP	14.7	14.7	14.9	16.
Deficit as a per cent of GDP	1.1	1.1	1.4	2.
NCR as a per cent of GDP	0.6	0.7	1.1	1.
Total Debt as a per cent of GDP	17.3	17.0	16.2	17.
Cumulative Net Borrowing for Ontario Hydro				
U.S.	4,506	4,379	5,573	6,05
C.P.P.	–	500	1,000	1,00
Contingent Liabilities (mainly Ontario Hydro)	7,904	8,553	9,284	11,12

1 Gross Domestic Product and Personal Income are calculated on a calendar year basis. The amounts appearing in a fiscal year column are for the preceding calendar year.

2 Ontario Finances, September 30, 1989.

Note: All funds are quoted in Canadian dollars.
N/A - not available.

Source: Ontario Ministry of Treasury and Economics.

1983-84	1984-85	1985-86	1986-87	1987-88	1988-89	Interim 1989-90[2]
21,412	23,893	26,240	29,544	32,453	37,256	40,726
24,565	26,452	28,854	32,178	34,942	38,735	41,296
3,153	2,559	2,614	2,634	2,489	1,479	570
864	857	1,009	1,286	1,203	1,429	1,047
(2,289)	(1,702)	(1,605)	(1,348)	(1,286)	(50)	477
27,406	30,041	32,904	35,103	36,981	39,014	39,952
2,860	2,090	2,102	1,194	901	700	(104)
151,945	171,499	186,166	204,700	225,428	249,497	271,177
131,947	146,193	158,388	170,480	188,338	206,399	225,064
8,798	8,902	9,006	9,113	9,265	9,426	9,570
3,116	3,374	3,654	3,852	3,991	4,139	4,175
14,997	16,422	17,587	18,707	20,327	21,896	23,517
16.2	15.5	15.5	15.7	15.6	15.5	15.2
2.1	1.5	1.4	1.3	1.1	0.6	0.2
1.5	1.0	0.9	0.7	0.6	0.2	0.1
18.0	17.6	17.7	17.2	16.5	15.6	14.7
6,487	7,206	7,189	6,667	6,033	5,692	N/A
1,000	1,000	1,000	1,119	1,508	2,097	N/A
12,711	14,220	15,963	17,603	18,595	20,559	N/A